Conclusion :

In the light of the various decisions of the Supreme Court, the issue may be summarised as under—

1. As per section 145 of the Act, the income, inter alia, chargeable under the head "Profits and gains of business or profession" is to be computed in accordance with either cash or mercantile system of accounting regularly employed by an assessee.

2. The application of the method of accounting for income-tax purposes *will, however, be limited* only for the purpose of quantifying the profits or for the valuation of assets. For example, for the purpose of ascertaining or quantifying the profits arising from construction contracts, the methods prescribed by the ICAI, vide Accounting Standard 7 may be adopted.

3. The method of accounting will not be decisive in the matter of whether a receipt will be subject to income-tax or an expenditure will be allowed as deduction while computing the profits and gains of business. *The same will be governed by the provisions of law relating thereto which may either be expressly provided in the Act [which would include accounting standards to be issued by the Central Government in exercise of the powers conferred upon it by section 145(2) of the Act] or enunciated by various courts of the country from time to time.* Any accounting entry made contrary to such express provision or enunciation of law will be ignored for the purposes of income-tax assessments, *notwithstanding the fact that the same may be recognised and accepted in accountancy parlance.*

[Note :—The reader's attention is also drawn to the heading "*Accounting v. Law*" in "Notes and Comments" at pages 49 to 53 in [1997] 227 ITR (Journal), dealing with this identical subject—Ed.]

Constituting Hindu undivided family property nucleus through gifts

T. N. PANDEY*

Established over centuries, the rule concerning Hindus has been that joint and undivided family is the normal condition in Hindu society. An undivided family is ordinarily joint not only in estate, but also in food and worship. The presumption, therefore, is that the members of a Hindu family are living in a state of union unless the contrary is established. The expression used in Hindu law denoting jointness is "Hindu joint family", while under the tax laws of the country, the phrase used has been—Hindu undivided family (HUF). The Supreme Court in *N. V. Narendranath* v. *CWT* [1969] 74 ITR 190 ; [1970] AIR 1970 SC 14 and in *Surjit Lal Chhabda's* case [1975] 101 ITR 776, has expressed the view that in tax statutes, Hindu undivided family has the same meaning as a Hindu joint family.

HUF—A separate taxable entity :

A HUF is a separate assessable entity under the Income-tax Act, 1961. According to section 2(7) of the Act, every person by whom tax is payable is an assessee. Section 2(31) defining "person", vide its clause (ii), includes a Hindu undivided family. As such a Hindu undivided family is a separate unit of assessment both under the Income-tax and Wealth-tax Acts.

HUF is not comprised of Hindus only :

When the British came to India and tax on incomes was introduced after the great Mutiny of 1857, undivided families were the normal feature in the country—living, vibrant and social entities—not only joint in food and worship but also commonly engaged in business, industry and commerce and these entities comprised not only Hindus but also Sikhs, Jains, Buddhists as well as Muslim communities like the Khojas of Gujarat. The British, while formulating the income-tax law for the country found it both practical, politic and convenient to include a Hindu undivided family as a unit for the purposes of levy of income-tax along with other entities like individuals, firms, associations of persons, companies, etc. Since then, a Hindu undivided family has been commonly understood to consist of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters and such a family is capable of owning and may in fact own property and the interest of its members in undivided family, though fairly well known in general terms, is not specifically demarcated till a partition takes place in the family.

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HUF need not own property under Hindu law :

In Hindu law, the existence of a joint estate is not an essential requisite to constitute a HUF/joint Hindu family. Hence, there could be Hindu joint families under Hindu law without owning any property. Possession of property is not under Mitakshara law a necessary requisite for the constitution of a joint family, though where persons live together joint in food and worship, it is difficult to conceive of their possessing no property whatsoever. Thus conceptually a Hindu undivided family can exist with an empty hotchpot, though it would be a rare case where a Hindu undivided family does not possess any property. In *Kuppalla Obul Reddy* v. *Bonala Vekata Narayana Reddy*, AIR 1984 SC 1171, the Supreme Court reiterated the well established proposition of Hindu law that though there is a presumption that every Hindu family is a joint Hindu family, there is no presumption that any property held by it or any of its members is also joint family property. In other words, under Hindu law a family may be possessed or may not be possessed of property. It would still be a joint family. But under the Income-tax and Wealth-tax Acts, a family without any income or wealth has no relevance.

Though as indicated earlier, in some cases the Supreme Court has equated a joint Hindu family with a Hindu undivided family under the income-tax law, but the fact of the matter is that it has given an extended meaning to the expression Hindu joint family. Whenever the nucleus of the Hindu joint family could be formed, it came to the conclusion that it was a Hindu undivided family. It was observed by the Privy Council in *Kalyanji Vithaldas* v. *CIT* [1937] 5 ITR 90, that for most purposes, the ancestral property may be usefully described as family property. But from this it cannot follow that in the eye of Hindu law, for being a family property, it must have ancestral nucleus or should have flowed to a member from that source.

What is understood by the phrase ancestral property :

The concept of "ancestral property" has been described in *Mayne's Hindu Law and Usage* (12th edition) at pages 538-539 as under :

"The second question is as to what is meant by coparcenary property. The first species of coparcenary property is that which is known as ancestral property. That term, in its technical sense, is applied to property which descends upon one person in such a manner that his male issue acquires certain rights in it as against him. For instance, if a father under Mitakshara law is attempting to dispose of property, we inquire whether it is ancestral property. The answer to this question is that property is ancestral property in the father's hands if it has been inherited by him as unobstructed property, that it is not ancestral if it has been inherited by the father as obstructed property. The reason of this

distinction is that, in the former case, the father had an effective vested interest in the property, before the inheritance fell in, and therefore his own issue acquired by birth a similar interest in that interest. Hence, when the property actually devolved upon him, he took it subject to the interest they had already acquired. But in the latter case, the father had no such interest in the property, before the descent took place ; therefore, when that event occurred, he received the property free of all claims upon it by his issue, and a fortiori, by any other person. Hence all property which a man inherits from a direct male ancestor, not exceeding three degrees higher than himself, is ancestral property, and is at once held by himself in coparcenary with his own male issue. When he has no male issue, the sister will inherit the property as separate property. But where he has inherited from a collateral relation, as for instance from a brother, nephew, cousin or uncle, it is not ancestral property in his hands in relation to his male issue, consequently his male issues have no equal rights as coparceners. They cannot restrain him in dealing with it, nor compel him to give them a share of it. On the same principle, property which a man inherits from his mother, or maternal grandfather, or maternal uncle, or other collateral relation in the maternal line, is not ancestral property. The grandsons who inherit property from the maternal grandfather cannot be said to constitute a joint family. It is settled by a decision of the Judicial Committee that the term, ancestral property, must be confined to property descending to the father from his male ancestor in the male line and that it is only in that property that the son acquires by birth an interest jointly with and equal to that of his father."

[The law was well-settled before the enactment of the Hindu Succession Act, 1956, that the property devolving upon a Hindu on the death of his father was Hindu undivided family property qua his son (which expression includes son's son, son's son's son). But after the coming into force of the Hindu Succession Act with effect from June 17, 1956, this position is no longer certain. The Allahabad, Assam, Madras, Mysore and Calcutta High Courts hold the view that when a son succeeds to the property of his father, he takes it as his self-acquired property qua his own sons. The Punjab and Haryana and the Gujarat High Courts, on the other hand have taken the contrary view. However, for the purpose of present discussion, it is presumed that such property is ancestral property.]

Whether property received from others can constitute joint family property of the Hindu undivided family for tax purposes ?

The view expressed by Mayne in the extract quoted above is that property which a man inherits from his mother, etc., cannot constitute

ancestral property in his hands. But the issue is, if the relations, collaterals, etc., gift their properties to the Hindu undivided family of a person, would these constitute Hindu undivided family properties of the donee family for tax purposes ? This proposition is being examined in detail in the subsequent discussion.

(i) It is the well-established legal position now that a self-acquired property of a person can become Hindu undivided family property if it is thrown in the common hotchpot and giving the Hindu undivided family character. A father with his sons may throw his personal property and give it Hindu undivided family character even if the family where the property is being blended has no existing properties of its own. It is not necessary that there should be joint family or the property of the Hindu undivided family with which the property thrown in the common stock may be blended. In *Addl. CIT* v. *V. K. Purwar* [1979] 116 ITR 908 (All), the Allahabad High Court, following the Madras High Court in *R. Subramania Aiyer* v. *CIT* [1955] 28 ITR 352 and Delhi High Court in *CIT* v. *Pushpa Devi* [1971] 82 ITR 7, held that a Hindu undivided family need not have any joint family property and even if there is no such family property to start with any member can validly throw his separate property into the hotchpot of joint family, and thereafter such self-acquired property acquires the character of joint family property. In *T. Ramdas M. Pai* v. *CIT* [1978] 115 ITR 815 (Kar), the Karnataka High Court expressed similar views holding that the law is also clear that a joint family need not own or possess any joint family property. It is also settled law that any individual member can, by throwing his individual property into the common hotchpot, impress his individual property with the character of joint Hindu family property. The Punjab and Haryana High Court in *Addl. CIT* v. *Inder Singh Uppal* [1975] 98 ITR 368, held that existence of joint family property before a member of the joint family throws his self-acquired property into the common stock is not necessary. In other words, the joint family property can be created by any member of the joint family impressing it with the character of the joint family property by an act which shows his volition and intention to surrender his separate rights on the property and to treat it as the property of the joint family.

Applying the Supreme Court decision in *CIT* v. *M. K. Stremann* [1965] 56 ITR 62, the Calcutta High Court in *CIT* v. *Bhikraj Jaipuria* [1979] 119 ITR 883, held that pre-existence of a nucleus of joint family property is not necessary for throwing the self-acquired property into the family hotchpot.

The Bombay High Court in *Damodar Krishnaji Nirgude* v. *CIT* [1962] 46 ITR 1252, held that the existence of ancestral nucleus is not essential. In fact such nucleus can be created by any of the members of

the family throwing his self-acquired property into the common hotchpot of the Hindu undivided family.

The Revenue in such cases has raised the plea that no gift can be made to a non-existent assessee. This view has not been found to be judicially and otherwise correct. Firstly, as mentioned earlier, for being a Hindu undivided family, owning property is not a prerequisite. Hence property can be given to a Hindu undivided family with an empty hotchpot. Further, the Punjab and Haryana High Court in *CIT* v. *Ghansham Dass Mukim* [1979] 118 ITR 930, negatived such plea and held the joint family is the normal condition of Hindu society and there was no bar to bequeathing property to a joint Hindu family and a will can be made in favour of a Hindu undivided family which is to come into existence. This conclusion was drawn by the High Court by relying on the Supreme Court decision in the case of *Surjit Lal Chhabda* v. *CIT* [1975] 101 ITR 776. From the various decisions of the Supreme Court, for example, *Pushpa Devi* v. *CIT* [1977] 109 ITR 730 and *Arunachala Mudaliar* v. *Muruganatha Mudaliar*, AIR 1953 SC 495, it follows that if a gift is made with the clear and unequivocal declaration that it is being made for the benefit of the family, such gifted property would bear Hindu undivided family character. The decisions of the Madras High Court in *Satyendra Kumar* v. *CIT* [1983] 140 ITR 840, *CIT* v. *Radhambal Ammal* [1985] 153 ITR 440 and *CIT* v. *M. Balasubramanian* [1990] 182 ITR 117 [FB], support and approve the view that, with a clear intention of gifting the amount of a Hindu undivided family, a Hindu undivided family may be created even in the absence of a Hindu undivided family nucleus at the time of gifting.

(ii) *Gift can be made to a Hindu undivided family even by a stranger :*

On the logic, given earlier, Hindu undivided family property nucleus can be created by receiving gifts from strangers with the stipulation that gift is being made for the benefit of a Hindu undivided family. The Supreme Court in *Pushpa Devi* v. *CIT* [1977] 109 ITR 730 has held that the Hindu undivided family can accept a gift from a person who is not a coparcener.

(iii) *Gift from a female relation to a Hindu undivided family–the latest Supreme Court decision :*

In *CIT* v. *K. Satyendra Kumar* [1998] 232 ITR 360 (SC), the question for the court's consideration was whether the assessee was liable to be assessed in the status of a Hindu undivided family in respect of properties received by way of gift from a lady relative. The Supreme Court has approved the decision of the Madras High Court in the case of this assessee in *Satyendra Kumar* v. *CIT* [1983] 140 ITR 840 (Mad).

In the decision rendered by the Madras High Court in *Satyendra Kumar* v. *CIT* [1983] 140 ITR 840, there was on record a finding that the donor provided gifts to the donee with a clear intention of benefiting the family. The donee kept the gifted amount as nucleus and carried on the business and there was no evidence that the donee at any time intended to hold the property as his property. The court basing on this approach of the donee in disclaiming any separate interest in the properties, held the same to be sufficient for the purpose of law for treating the property as Hindu undivided family property. It went on to further hold that this case was one where ab initio at the very moment the property was acquired, it was acquired as a joint family property via the hands of the donee as the donor had made it amply clear that the funds were to be utilised only for the family's benefit. The observation in this case to the effect that when, once the intention of the donor to donate the funds for the joint family was conceded, the presence of the basic nucleus of the joint family was established, is very significant from the planning point of view. It is only necessary for the donor to clearly state his intention that the gift is meant for the joint family.

It has been observed in this decision by the Madras High Court that the decision of the Supreme Court in *Pushpa Devi* v. *CIT* [1977] 109 ITR 730, is an illustration of the position under the Hindu law that there can very well be a gift of property in favour of an Hindu undivided family as such, and a female member of a family is not disentitled from making such a gift beneficial to the family in its entirety, merely because she happens to be a member thereof. In such a case, if the intentions were clear, the gift would be regarded as a gift to the joint family as such and not merely to the collection of individuals, who happen to make up the joint family, at the moment of the gift. If the property, thus, becomes the property of the joint family, it is susceptible to all the incidents of coparcenary property thereafter, including such incidents as right by birth, right to partition, the amenability of the property to constitute itself as a nucleus for further acquisitions to the joint family estate and the like.

The decision of the High Court has been confirmed by the Supreme Court with the following observations (page 363) :

"The dispute in this case was whether the assessee was liable to be assessed to tax in the status of a Hindu undivided family. The properties held by the assessee came from a lady relative. The Tribunal was of the view that since the source of the property was a gift it could not be treated as a joint family property. The High Court pointed out that the donor, Smt. Shyamalambal, wife of K. Satyanarayana, had funds of her own. With a clear intention of benefiting the family as a whole she

provided funds to K. Appa Rao. The money in the hands of K. Appa Rao has to be treated as joint family property because Smt. Shyamalambal clearly indicated at the time of making of the gift that the funds were to be utilised only for the benefit of the family. K. Appa Rao, M. Satyendra Kumar and other brothers jointly held the property. The Tribunal (High Court ?) from all these facts came to the conclusion that the money received by the assessee was part of the joint family property. The assessee has to be taxed in the status of an individual (HUF ?).

We do not find any reason to interfere with the findings of the High Court."

Concluding comments :

This decision of the Supreme Court gives very good scope for tax planning specially in the background of the position that there is no gift-tax in the country with effect from October 1, 1998. However, to reap the benefit of tax planning by this method, certain precautions will have to be taken. For example, there should be a clear declaration of intention through affidavit that the gift is made to the Hindu undivided family of a particular person consisting of himself, his wife and children and not to the donee as an individual. In *C. N. Arunachala Mudaliar* v. *C. A. Muruganatha Mudaliar* [1954] SCR 243, it was held that the court would have to collect the intention of the donor from the language of the document taken along with surrounding circumstances in accordance with the well known canons of construction. In the decision rendered by the Madras High Court in *Satyendra Kumar* v. *CIT* [1983] 140 ITR 840, there was on record a finding that the donor provided gifts to the donee with a clear intention of benefiting the family. Hence, it is necessary that proper precaution be taken in tax planning in this matter.
