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The untold potential of family offices in India through the prism of the Hindu undivided family

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The concept of the family office has been around for about 500 years and is generally attributed to the Medicis. The Rothschild family was the prototype of the family office started in the 1760s by Mayer Amschel Rothschild (1744–1812) in the Free City of Frankfurt, Holy Roman Empire. Over a period of 100 years, the Rothschild family developed branches in the United Kingdom, France, Austria and Naples. During the 19th century the Rothschild family possessed the largest private fortune in the world.

The concept of family offices in modern times started around the 19th century with wealthy businessmen setting up offices to take care of their family assets. A notable example of a family office which started off as an SFO but later became an MFO is Rockefeller Financial Services. It was set-up by John D Rockefeller to manage his family's business and philanthropic pursuits, but now advises multiple families, including the Rothschilds.

Influence of family offices in Asia

The family office structure is less common in developing countries. "While family offices are well established in financial centres such as Hong Kong and Singapore, we see a growing interest in family office setups from entrepreneurial families in India, China and Taiwan, as well as in South East Asia", said Kathryn Shih, CEO of UBS Wealth Management Asia Pacific.

In 2011, according to Forbes, India was home to 55 billionaires, the third highest number in the world, after the United States (422) and China (146). Yet because much of its wealth was accumulated in the last 60 years, the country's use of the family office model has remained limited.

In 2015, it was estimated that there would be close to US$128 billion that would change hands in intergenerational wealth transfers in India over the next decade. As a result, the need for managing family issues and wealth has become an enormous growth industry.

Much of the wealth generated in India after the liberalisation of its economy in 1991 is still in the hands of the first generation, but this intergenerational transfer is witness to a development in the industry. An increasing number of wealthy families have been looking to adopt their own versions of the western family office concept, adapting it to fit their cultural frameworks. "The new wealth being created in India ... is new to the family office concept and as such is developing models, but also ones that are particular to their state of wealth creation and cultural differences" (UBS Wealth Management Report 2015).

Wealth creation through Hindu families

It has been acknowledged that the inheritance laws of Hinduism allowed for wealth to be held collectively by a joint family for long durations and encouraged capital accumulation (Bagchi 1985, 26–28; 1999, 50; Leonard 1981, 197).[1] As a consequence, wealthy Hindu families could hold onto and augment their stock of capital over the course of many generations.

One such cultural difference is the structure of the Hindu undivided family (HUF). The HUF is an extended family arrangement where every member is a lineal descendant of a common ancestor. "The HUF exists as a result of sapinda bonds between its members. Sapinda bonds are formed as a result of birth, adoption or marriage and are necessary for the existence of the joint family" (Anantdeep Singh – PhD Thesis 2008).

This family includes a common ancestor who is generally the eldest and three generations of his descendants. There is no limit to the size of a joint family. The numbers of members may change due to birth, adoptions, marriages, death partitions and severance of ties. The HUF continues to exist indefinitely, unless it is partitioned, or if it has no other members it can add other members to it. This family arrangement is governed by the Hindu Succession Act 1956. It is a codified act and is concerned with the management, transfer, devolution and ownership of inherited property among the historic structure of the Hindu joint family.

Legal sanctification of the HUF

The first step towards the legal sanctification of the HUF as the institutional basis for the organisation of the business group was achieved through the codification of Hindu personal laws. First, the Hindu Code (adapted as a state code) defined a Hindu as anyone who was not a Muslim, Christian, Parsi or Jew and thus by default included followers of other institutionalised religions like Buddhism, Jainism and Sikhism in the Hindu Category. The Code recognised two schools of thought to regulate and administer Hindu laws. The Mitakshara school and the Dayabhag school. The Mitakshara school followed the concept of inheritance based on propinquity or the closeness of the blood relation. The allocation of parental property was accorded on the rule of possession by birth which meant that the sons of the family had exclusive right in the property of the joint family while the daughters did not have any rights. It was from this school of thought that the 1956 Succession Act was developed.

The Dayabhaga school sought that the law of inheritance was based on the principle of religious reward or spiritual benefit. In this school, females could inherit the property and the sons of the family did not have the right to exclusivity of inheritance. The sons do not acquire any interest by birth, but their right arises after the death of the karta – the ultimate head of the family. This school was only observed in Bengal. The Mitakshara is more conducive to capital accumulation than the Dayabagha and this may help explain why Bengalis played only a small role in India's industrialisation[2] despite the fact that the province of Bengal had exposure to Western business methods as early as the 1820s through partnerships between Indian and British businessmen.

The patriarchal basis of the property rights structure was institutionalised in the organisation of wealth and property. Women were denied an equal share in any property. Specifically, they were denied any property right based on the feeble excuse of preventing fragmentation of land. Therefore, religion, caste and patriarchy were installed as the institutional basis for determining property rights. Property is classified into two broad categories: joint property and separate property. Joint property is held collectively by the family and is divided into two categories: ancestral property and non-ancestral property. Ancestral property can only be obtained by two means – inheritance and partition – while property acquired through other means is not considered ancestral.

There is an important difference in the HUF between a coparcener and a member. A coparcener is a person who acquires interest in a joint family property by birth. The essential difference between a coparcener and a member of an HUF is that a coparcener can enforce partition of the HUF while a member cannot. A coparcener in an HUF may have separate properties which are distinct from the properties of the HUF. Such separate properties may be the coparconer's self-acquired properties or may have been acquired by such a coparcener through gifts or bequests. A coparcener may, however, choose to integrate such property into the joint family property by voluntarily pooling it in the common stock of the HUF, with the intention of abandoning his or her separate claim in such property. Historically, it has been the male descendants up to the fourth generation who are considered coparceners. The share of each coparcener is not constant and may change with the birth or death of other male coparceners. Classical Hindu law discouraged women from owning property and only grudgingly allowed a separate form of property for the maintenance of women.

Prior to its codification in law through the Hindu Succession Act 1956, the HUF structure had been a successful entity in retaining and building capital by pooling resources and limiting through strict internal governance the partition of the estates. As early as the 17th century, the Gopaldas Manohardas family of northern India provided credit and services such as currency exchange to its clients which included land owners, the aristocracy and the East India Company. Based in Benares, now modern-day Varanasi, it was able to establish benches in 52 cities throughout India. The business was partitioned into two branches in 1787. These businesses are not a collection of persons who have entered into a partnership for the purpose of sharing the profits of a business carried on by all or any of them and therefore they are not firms. Instead, these businesses exist as a result of the sapping bond between their members. A significant portion of the success of the family business can be attributed to the fact that it is able to recruit other male members of the joint family such as nephews to run its numerous branches while the eldest male of each generation retained the power to make key decisions. The family was able to use Hindu customary law to hold its wealth for generations before its partition split the wealth between the two branches.

The origin of the HUF codified in 1956 lies essentially in the 1937 amendment to the Hindu Succession Act which was a decade before

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independence, and the existence of other religions at that time were a negligible minority except for the Muslims (who were also relatively small in number). Therefore, among other economic reasons the creation of the structure was primarily done by the British to please the Hindu feudal families and earn their loyalty by creating an ameliorated position for them over the common Indian. With the support of the elite Hindu feudals it was possible for the British to thwart the relentless efforts of the Indians to free themselves from the British Raj. There is no equivalent structure or provision for business groups belonging to other religions.

There are two fundamental characteristics of the Hindu joint family structure that makes it an effective vehicle for accumulation of capital. Joint family property can be held collectively for an indefinite period until a partition occurs which will allow the group to develop as interdependent structures and businesses under the one Hindu joint family structure.

From the brief discussion above, we can see that the Hindu joint family which ultimately became the HUF possesses two characteristics in common with modern corporations. First, the Hindu joint family is a durable institution. Its existence is not contingent upon the existence of any particular member and it may only be dissolved under special circumstances. The second similarity between the joint Hindu family structure and the modern corporation is that both may branch out their business activities into new areas while maintaining the central point of control.

These two areas acquire crucial importance because an individual using the HUF structure would have the experience and the skill-set required for operating in an institution that is durable and can branch out into different types of businesses.

The analysis of 25 landmark HUF-related cases involving some of the top business houses in India shows the following uses of the HUF:

- To keep property within the Hindu family (based on the male line of descent) using the definition of the Hindu as adopted in the acts based on the Hindu Code.
- Splitting of income between individuals and HUFs for the purpose of tax avoidance.
- To evade large amounts of tax by entering into complex transactions between the HUF and group companies with the same person as karta and chairman respectively.
- To gain benefits of tax exemptions in capital gains.
- Holding land of enormous value in HUFs claiming to be received as dowry by ancestors.
- Interlocking of funds and assets between HUFs and group companies.
- To make a profit from speculation through sale and purchase of shares of group companies by the HUF.
- Multiple HUFs within the same family with overlapping kartas and members and then multiple dealings of a single property by these different HUFs, eg same land pledged for different purposes by repeated transfers between HUF holders.

Potential of HUFs as a family office

The interlocking of HUFs in Hindu corporate entities makes it an effective vehicle for family control over all the operations and stakes of the corporate business group and continuous rearrangement of liabilities and tax obligations between individuals and the HUFs. The prevalence and spread of joint stock companies have become a useful appendage for the HUF rather than replacing the traditional family model of business. The HUF can be a proprietor of one or more business firms by maintaining names separate to the HUF as a business entity. Further, the HUF can own different kinds of assets including factories, land, property and trades.

As well as capital accumulation, the HUF structure has been effective for tax minimisation and for groups with international holdings.

The HUF structure allows for complex overlapping directorships and inter-corporate holdings provides yet another layer for ensuring family control over corporate governance structures as well as providing an avenue for concessions on wealth and income. The number of HUFs assessed for income tax increased by 47% in 1997–1998 and registered double digit annual growth rates in eight out of 20 years between 1990 and 2010. The nuclearisation of families is directly related to a proliferation of HUF accounts among middle-class, double-income, upwardly-mobile caste Hindu India.

One of the features associated with this era has been that family-owned business groups have been transforming themselves into multinationals without an increase in their total corporate liability through vertical and horizontal integration. HUFs provide another channel of tax – saving on income and wealth for not only upwardly mobile Hindu families in India but also for Hindu non-resident Indians (NRIs). The Income Tax Act 1961 (the Act) specifies the resident status of citizens and entities into three broad categories: resident, non-resident and not ordinarily resident (NOR). The act provides that an HUF can be an NOR if the karta is an NRI and has stayed outside India in nine out of 10 previous years or has remained in the country for less than 729 days in the past seven years.

This legally allows business families to register an HUF in India and conduct their business abroad for years and establish the presence of the karta of the HUF in the country for the minimum stipulated period to enjoy the benefits of the HUF structure. The HUF was treated on a par with corporate entities at this point and as detailed in the act allows the karta to reside outside the country. The HUF benefits can be taken advantage of as long as there is an official devolution of the powers of control and management to the other members of the family who stay in the country. This of course provides diverse opportunities and privileges for the HUF in terms of accessing human capital and opportunities and capital provided through the prodigious Indian diaspora.

In 2019, with 17.5 million Indians living abroad the Indian diaspora is the largest in the world (International Migrant Stock, 2019), a data set released by the Population Division of the UN Department of Economic and Social Affairs (DESA). Professor Gurdip Singh, a reputed economic journalist and Professor in Economics at the University of Delhi, said: "one of the biggest tax dodges is exemptions enjoyed by people getting themselves assessed as members of a Hindu undivided family (HUF)".

Role of the karta

The role of the karta is very distinctive in the Hindu joint family. The unique nature of the position refers to the diverse powers held by the karta as the decision maker in a range of respects of the family. As head of the family the karta has power to manage and run the HUF and their power is absolute. The karta has power over all income, revenue and expenditure and any member who earns from outside the family business is likely to pay their income to the karta. Due to this power the karta is responsible for all the revenue, income and expenditure of all the members. The karta has the right to represent the joint family in all legal, religious or social matters in the family. The karta has absolute authority to enter or rescind contracts on behalf of the family for which they are all legally bound. This includes marriages – the karta is liable especially for the daughters – the funds for a dowry are taken from the joint family ownership and expenses for marriage celebrations are incurred by the joint family fund.

It is important to understand the dominant position of the karta in Hindu family law. An adult male member who manages the affairs of the HUF is known as the karta or in western corporate terms the equivalent of the CEO and chairman of the board combined. Generally, the most senior adult male member of the family is made the karta. However, the most senior member of the HUF may give up his right and a junior member may take this position, if the senior member is not working in the interests of the family. The debts and liability incurred by the karta may be passed on to his son and grandson, but not to other coparceners in the family.

The combination of HUF with corporate governance structures is mediated by the role of the karta in the dual role as an individual legal person and as a karta for the HUF. For instance, an HUF cannot enter into a partnership with other persons, as it is not a legal person, but the karta on behalf of the HUF may do so. Similarly, the karta and other members of an HUF are entitled to receive a salary and compensation as a legal person.

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Hindu Succession Act 1956 brought about an important change to the structure of the HUF. Prior to 2005 only lineal male descendants were regarded as coparceners, whereas daughters merely attained the status of members at birth and not coparceners.

The legislation had not kept pace with the changing needs of society and in 2000 a Law Commission report suggested reforms in relation to women's property rights and inheritance. The 2005 Amendment conferred equal rights upon daughters, with the result that they have equal right as sons in the properties of the HUF. Contrary to assertions that the 2005 amendment established a gender equal basis of land and agricultural property, it only gave daughters the right to be coparceners in HUFs under Mitkashara rules and excluded wives and daughters-in-law. Moreover, the status of the karta and the HUF as a form of property holding in a body incorporate were not affected by this amendment. The status of the karta was preserved in its implication for inheritance rights as well as the HUF as a tax entity. Individuals often use an HUF as a tax-planning avenue and for succession planning.

In another significant development, as recently as 2016 in a landmark ruling that was passed in the High Court of Delhi regarding a woman's status as karta of an HUF it was established that daughters also had the right to become kartas. It is a significant step forward for women in family businesses and family offices. The rights granted in the 2005 amendment to the Hindu Succession Act 1956 had been expanded and the gender discrimination of the Mitakshara school ended.

HUFs and the increasing influence of family offices in India

According to the Association of International Wealth Management of India (AIWMI), India has close to 50 SFOs managing assets in excess of $15 billion.

In terms of family offices, the increasing professionalisation of structures and processes has created an enormous amount of opportunity in India. When the Chairman of Pidilite Industries, Madhukar Parekh, decided to recruit senior people from multinational companies he found it challenging to convince them to join a family-run company where the aim was to disengage the extended family from the day-to-day operations. It was a big change for the company but the HUF system had created a mechanism for members to follow the structure and the vision of the karta.

The development of a family constitution within a family office is seen as an evolution of the HUF.

> *The HUF reflects the essence of the joint family system as the structure made the family responsible for ensuring the economic wellbeing of all its members but as the HUF started disappearing, new mechanisms such as family constitutions and shareholder agreements have taken its place; the goal is the same – to keep the family together.*[3]

Interestingly, the idea that with modernisation and nuclearisation of families the Hindu joint family system and the HUF would decline is not necessarily the case. The HUF has still proven popular with families because beneficiaries can save a greater proportion of their income by protecting it under the cover of high exemptions and transfer facilities available to an original HUF, these benefits are multiplied because of the smaller sizes of the families. There are issues with the structure of a multi-headed *hydra*-like system and this where the strength of the karta as well as supporting mechanisms of family constitutions and other mechanisms in terms of corporate governance are important for the effective functioning of the HUF.

The HUF structure provides a good basis for capital accumulation, tax minimisation and the ability to have a range of interlocking structures controlled by one overarching entity with one absolute manager – the karta. As the HUF can only be divided through partition, its durability over generations is effective for capital accumulation.

Of course, there are critics of the HUF structure. India is described as a "Sovereign, Socialist, Secular, Democratic Republic", however some believe that treating the HUF as a separate entity available only to Hindus threatens the basic essence of secularity that has been embodied in the spirit of India. The second criticism of an HUF is that it is essentially a manifestation of customs followed by the Hindu society and the laws related to constitution, operation and management of HUFs are not codified.

The 2016 ruling to include female coparceners eligible as kartas, brings the HUF structure into line with gender development of the 21st century. In India, women have proven themselves as leaders,

In terms of family offices, the increasing professionalisation of structures and processes has created an enormous amount of opportunity in India.

The HUF system may well be imperfect, but in a market set to expand at an exponential rate the 2019 report by Credit Suisse details that private wealth in India swelled up to US$12.6 trillion last year, growing four-fold since 2000.

successful entrepreneurs and CEOs of banks and companies even while juggling their roles as caregivers. The development of women in the senior echelon of family offices and taking over the traditional role of karta has not reached parity with their male counterparts and, in fact, in a Camden Wealth 2018 report on family offices gender imbalance was one of the principal issues in family offices. Amit Patni, whose family office Raay Global Investments has investments in a diverse range of asset classes and new business ventures said that: "The Indian family office should involve women of the family more often than they do currently. They need to be involved in family meetings to keep them abreast of all investment decisions, portfolios and systems".

The HUF system may well be imperfect, but in a market set to expand at an exponential rate the 2019 report by Credit Suisse details that private wealth in India swelled up to US$12.6 trillion last year, growing four-fold since 2000. The HUF may be a useful structure for a family office to develop around.

The number of HNWIs in India is expected to rise to 400,000 UHNW families, which will have a combined net worth of US$5 trillion by 2025.

The business community in India is remarkably diverse including but not limited to Hindus, Jains, Buddhists, Parsis, Jews and Muslims. This article and the structure of HUF applies only to those groups included in the HUF system – Hindus, Buddhists and Jains.

Note: The authors are planning a second article in their series of family office structures based on specific cultural alignments that will deal with alternative structures based around Islamic, Parsi and Jewish family structures in India.

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2 RS Rungta, *The Rise of Business Corporations in India*, 1850-1900, Cambridge, Cambridge University Press, 1970.

3 Professor Kavil Ramachandran, Executive Director, Schmidheiny Centre for Family Enterprise, ISB.

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