

PRESENTATION ON DIRECT TAXATION PROVISIONS AS APPLICABLE TO TRUSTS/ BENEFICIARIES



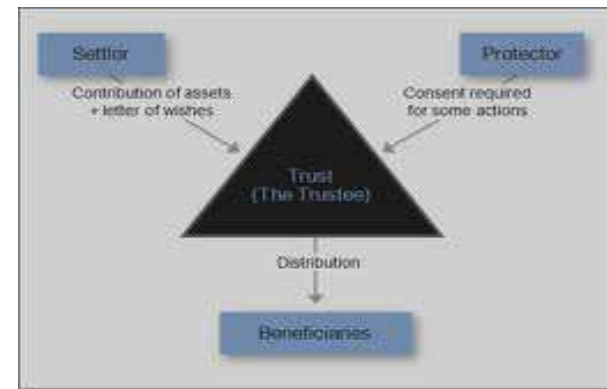
WIRC, Seminar on ESTATE PLANNING-
11th January, 2014

CA SANJEEV LALAN

TRUST?

- ✓ A Trust is a relationship wherein:
 - ❑ a person or entity holds legal title – THE TRUSTEE
 - ❑ on certain property-THE TRUST PROPERTY ,as also bound by a fiduciary duty to exercise the legal control
 - ❑ for the benefit of one or more persons or entities- THE BENEFICIARY, entitled to beneficial or equitable interest
 - ❑ governed under the laws of THE INDIAN TRUST ACT, 1882 and THE RELIGIOUS ENDOWMENTS ACT, 1863, CHARITABLE AND RELIGIOUS TRUSTS ACT, 1920, CHARITABLE ENDOWMENTS ACT, 1890
 - ❑ a person or the entity that creates trust referred to as THE SETTLOR or AUTHOR OF THE TRUST

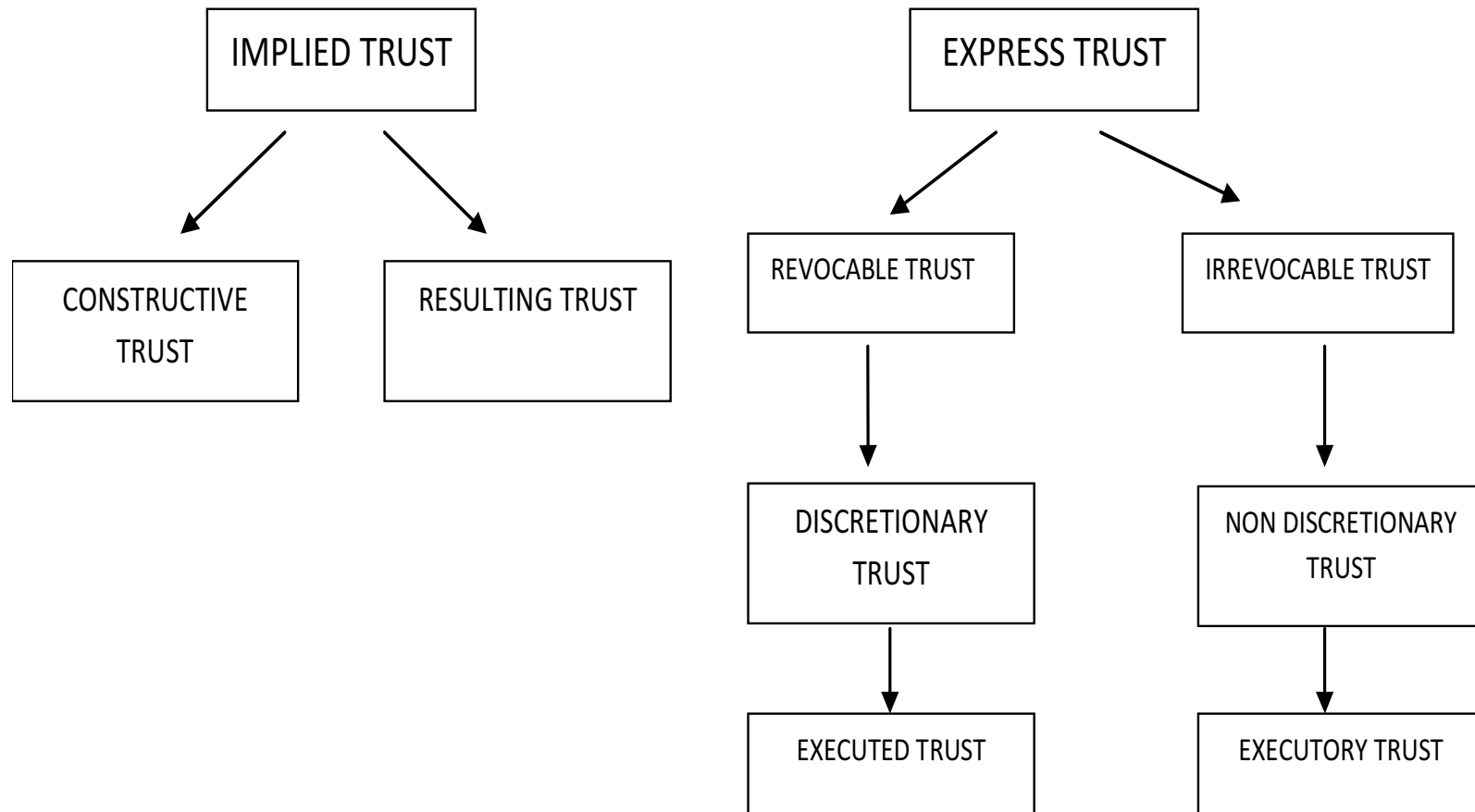
Section 7 of Indian Trusts Act envisages creation of trust by a person competent to enter into contract or by minor through permission of principal civil court of Original jurisdiction ,unlike Public trust which can be formed by any person



PROVISION UNDER INCOME TAX ACT relating to Trust

- ✓ Section 2(15) Defines Charitable Objective
- ✓ Section 10(23C) Provides exemption to educational, charitable and religious public institutions operating not for profit purposes
- ✓ Section 11 to Section 13 Provides for tax treatment in case of Charitable Trusts
- ✓ Section 80G Deals with deduction in respect of certain funds, Charitable institutions, etc
- ✓ Section 160-167 Deals with liability in special cases i.e. representative assessee which includes taxation of private discretionary trust

TYPES OF TRUST



PRIVATE TRUST- A Tool in Estate Planning

- ✓ Private trusts are in nature of settlement. For stamp and Registration purposes, the same to be treated as settlement

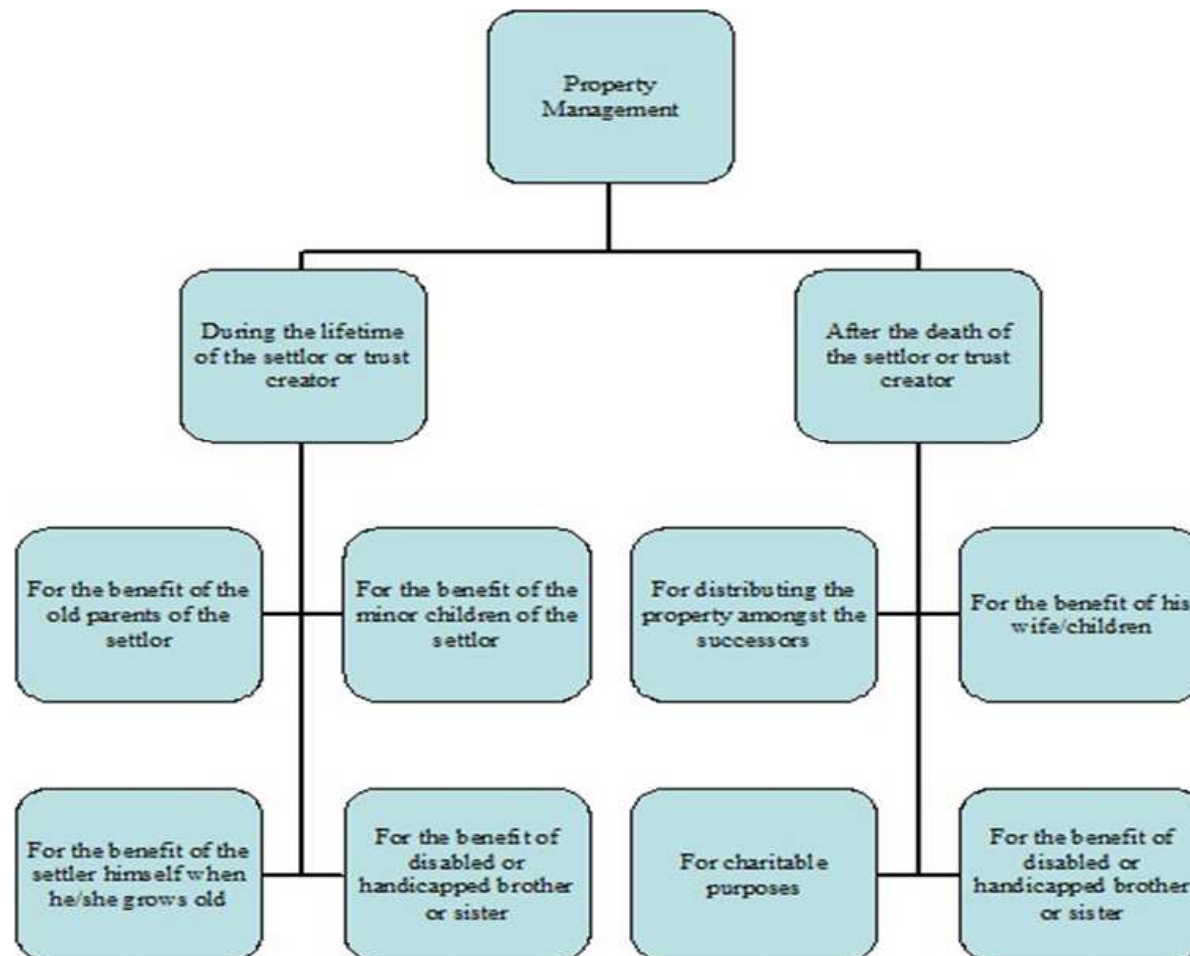
- ✓ Modes of creation of a Private Trust:
 - Oral Trust
 - Can be created where the trust does not involve any immovable property
 - Cannot serve the purpose for the Income Tax Act as such trust are without any declaration in writing
 - Inter Vivos- A Trust created during the lifetime of the grantor
 - Will (Bond)

PRIVATE TRUST- A Tool in Estate Planning

- ✓ Stamp duty Implications: Private Trust created through trust deed, wherein there is transfer of immovable requires registration and stamp duty is to be paid on the entire value of the property transferred
- ✓ Article 64- Indian Stamp Act, 1899 comprehends a trust deed as a *declaration of or concerning any property when made by any writing not being a will*
- ✓ Trusts created by way of will are not liable for stamp duty implications
- ✓ Private trusts are void for perpetuity unlike charitable trusts

NEED FOR CREATION OF A PRIVATE TRUST

✓ Need for creation of a private trust is depicted as under:



LINGERING TAX BENEFITS FOR PRIVATE TRUST

✓ Outlook on lingering tax benefits of a private trust as most of the benefits are taken away through anti avoidance provisions

✓ Private Trusts are of two basic types:

Specific Trust

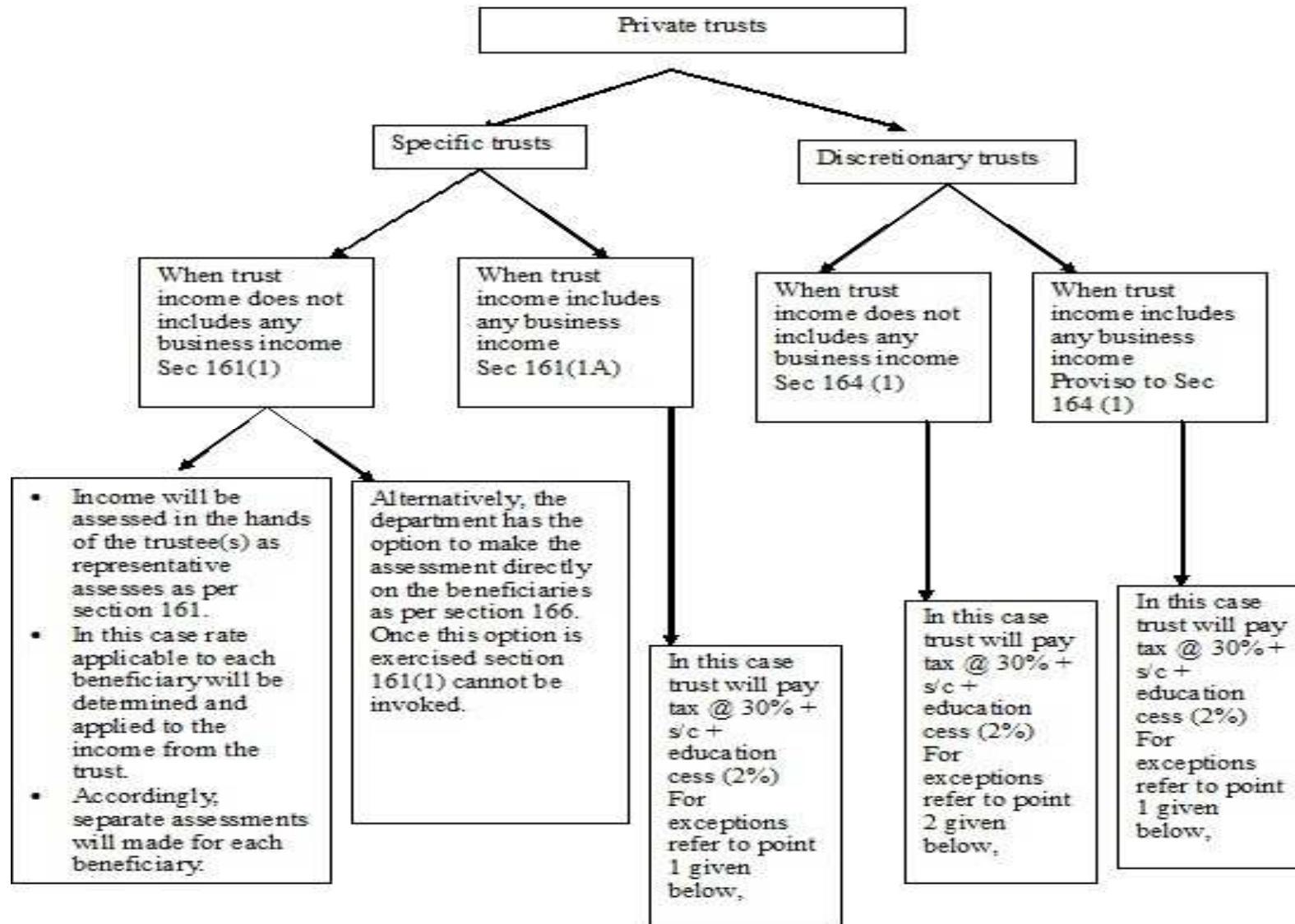
Wherein the shares of the beneficiary are known and ascertainable

Example: An Individual creates trust for his 5 daughters and the share of each daughter is mentioned in the deed to be 20%, then such trust is said to be specific trust

Discretionary Trust

No individual shares of the beneficiary is mentioned in the trust deed and the income is distributed to the beneficiary at the discretion of the trustee

AN OVERVIEW- TAXABILITY OF PRIVATE TRUST



AN OVERVIEW- TAXABILITY OF PRIVATE TRUST (Contd....)

- ✓ **Point 1:** In the following case rates applicable to Individuals will be charged – Status AOP:
 - If the trust has been declared by way of a will from which business income is derived and;
 - It is exclusively declared for the benefit of any relative dependent on the settlor for support and maintenance;
- ✓ **Point 2:** In the following cases rates applicable to Individuals will be charged – Status AOP:
 - Where none of the beneficiaries has taxable income or is a beneficiary under any other private trust; or
 - Where the relevant income or part of the relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him;
 - Where the trust yielding the relevant income or part thereof was created by a non-testamentary instrument before 1-3-1970 and the A.O. is satisfied that it was created bona fide for the benefit of the dependant relatives of the settlor, or where the settlor is HUF, exclusively for the benefit of the dependant members
 - where the relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund or pension fund or any other fund created bona fide by a person carrying on a business or professional exclusively for the benefits of his employees

TAXABILITY OF PRIVATE TRUST- Specific Points

✓ **Charge of tax in case of oral trust-Section 164A**

“Where a trustee receives or is entitled to receive any income on behalf or for the benefit of any person under an oral trust, then, notwithstanding anything contained in any other provision of this Act, tax shall be charged on such income at the maximum marginal rate”

✓ **Case where part of trust income is chargeable – Section 165**

“Where part only of the income of a trust is chargeable under this Act, that proportion only of the income receivable by a beneficiary from the trust which the part so chargeable bears to the whole income of the trust shall be deemed to have been derived from that part”

Therefore, beneficiary of a specific private trust shall be taxed only to the extent of their entitlement of income from the property and not on the entire income from the property

- ❑ **CWT vs. Arvind Narottam [173 ITR 479 (SC)]**- Valuation of wealth-tax when annuity was taxable , was also restricted to the capitalized value of such annuity or the beneficiary’s right to receive any benefit on the valuation date and not on the entire value of the property

TAXABILITY OF PRIVATE TRUST- Specific Points

✓ **Trust created for the benefit of the minor**

- ❑ Provisions of section 64(1A) provides for clubbing the benefits received during the minority to be clubbed in the hands of parents with the higher income
- ❑ Notwithstanding any contained in the clubbing provisions, wherein the minor has right to receive income accretion from the trust property on attaining majority, the clubbing provisions shall not apply

CIT vs. M.R. Doshi [211 ITR 1 (SC)]

- ❑ Bunched income during minority to be taxed in the single year being the year in which minor attains majority

Ganesh Chhababhai Vallabhai patel vs. CIT [283 ITR 193 (Guj)]

TAXABILITY OF PRIVATE TRUST- Specific Points

- ✓ Section 164(ii) dispenses with the need for adoption of maximum marginal rate even where the shares of the beneficiary are indeterminate, if a trust is declared by a will exclusively for the benefit of the dependent relatives and such trust is the only trust so declared by the settlor

- ✓ Income of a trust inter vivos for the benefit of unborn children or prospective wife cannot be clubbed
 - L. Gouthamchand vs. CIT [176 ITR 442]**
 - CIT vs. Brig Kapil Mohan [252 ITR 830]**

- ✓ Trust is invalid when the beneficiary are inexistence
 - CIT vs. Trustees of Keshav Mohta Family Trust [232 ITR 875]**

TAXABILITY OF PRIVATE TRUST- Specific Points

- ✓ Section 166-No Bar to a direct assessment in the hands of the beneficiary in respect of the income derived by him
CIT vs. Kamalini khatau [209 ITR 101 (SC)]

- ✓ Income assessable in the hands of the beneficiaries, when it becomes due to the beneficiary
Moti Trust vs CIT [236 ITR 37]

- ✓ **All the beneficiaries cannot be subject to assessment as an AOP**
 - ❑ Shares of all the beneficiaries need not be clubbed together for determining the tax liability in the hands of the trustee, when the shares of the beneficiary are determinate.
CWT vs. Trustees of H.E.H Nizam's Family
 - ❑ No attempt to be made to tax the trustee, where the beneficiary have already been assessed- Circular No. 75 dated 24/08/1966
 - ❑ Settled law- Beneficiaries cannot be assessed as a single unit for the rate purpose, when their shares are definite, even if the income is from business assessable at maximum marginal rate

TAXABILITY OF PRIVATE TRUST- Specific Points

- ✓ Wherein private trust is charged at the maximum marginal rate under section 164(1), no basic exemption limit is applicable

Surendranath Gangopadhyay Trust vs CIT [142 ITR 149]

- ✓ **Board circular no. 157 dated 26/12/1974**

In initial assessment, the assessing officer should opt to assess either the trust or the beneficiaries and once that option is exercised , the same cannot be taxed in the other person's hand (beneficiary or the trustee, as the case may be)

PRIVATE TRUST vis-à-vis Section 56(2)(vii)

- ✓ Determination on the status of the recipient
- ✓ Concept of “receipt”
 - ❑ In what Capacity such recipient should ‘ receive ‘ any cash, immovable or movable property so as to get covered under the provisions of this section
 - ❑ Point of time such recipient should be said to have received such property
- ✓ Determination on the adequateness of the consideration in terms of provisions of this chapter