TAX PLANNING THROUGH HUF, FAMILY ARRANGEMENT & WILL - CRITICAL ASPECTS

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TAX PLANNING

- Tax planning is a legal way of reducing your tax liabilities in a year. It will help you to utilize the tax exemptions, deductions, and benefits in the best possible way for minimizing your tax burden. However, it should be done in a legal manner.

- Tax planning is the analysis of one's financial situation from a tax efficiency point of view so as to plan one's finances in the most optimized manner.

- Tax planning allows a taxpayer to make the best use of the various tax exemptions, deductions and benefits to minimize their tax liability over a financial year. Tax planning is a legal way of reducing income tax liabilities, however caution has to be maintained to ensure that the taxpayer isn't knowingly indulging in tax evasion or tax avoidance.

HUF – YOUR PRIZE STATUS FOR TAX PLANNING

HINDU UNDIVIDED FAMILY

- The term “Hindu Undivided Family” (HUF) has not been separately defined under the Direct Tax Laws and, therefore, this expression must be understood as defined under the Hindu Law.

- As per Hindu Law, an HUF is a family consisting of all lineal male descendants of a common ancestor and includes their wives and unmarried daughters. The death of the common ancestor does not lead to the dissolution of a joint family. The next eldest make member becomes the head of the family and the family continues to exist.

- It may consist of other lineal descendants or it may consist of collaterals. Upper links get snapped and lower ones come into existence, and the joint family continues to exist. So long as the line does not become extinct, the joint family continues and can continue indefinitely, almost until eternity.

- A Hindu coparcenary is a much narrower concept than the Hindu Undivided Family and includes only male members who acquire an interest in the joint family property by birth. Such make members are known as coparceners.

- The interest of each coparcener in the joint family property is fluctuating, capable of being enlarged by death and liable to be diminished by the birth of sons to coparceners. The eldest male member of the HUF who is vested with the authority of managing affairs of the HUF is known as "Karta".

- As per Hindu Law, Jains, Sikhs and Indian Buddhists are also included in the definition of Hindu and, therefore, the provisions relating to HUF also apply to them.

- As held by the Supreme Court in the case of `Gowli Buddanna v. CIT' 60 ITR 293, under Hindu Law, a joint family may consist of a single male member and the Income-tax Act also does not indicate that the HUF as an assessable entity must consist of atleast two make members.

- Morever, in the case of `CIT v. Veerappa Chettiar' 76 ITR 467 (SC), the Supreme Court has held that even when a joint family is reduced to female members only, it continues to be an HUF, since there is a potential coparcenary as any widow by adoption can induct a coparcener into the family.

- The Gauhati High Court in the case of `CIT v. Arvind Jhunjhunwalla & Sons' 223 ITR 45 has held that an HUF gets constituted immediately upon the marriage of an individual. The High Court also rejected the contention of the Income-tax Department that that until there was the birth of a son in the family, the income of the HUF would be liable to be assessed in the individual case of the Karta.

- Similarly, the Madras High Court Full Bench in the case of `CIT v. M. Balasubramanian' 182 ITR 117 and the Punjab High Court in the case of `CIT v. Ghanshyamdas Mukim' 118 ITR 930 have held that where the donor or testator has given a gift or property under a Will with the clear intention that it would belong to an HUF, the income arising from such property would be liable to be taxed in the hands of the HUF.

ANCESTRAL PROPERTY

Meaning : All property inherited by a male Hindu from **his father, father's father or father's father's father, is ancestral property.**

- **General Understading :-** The essential feature of ancestral property according to Mitakshara Law is that the sons, grandsons and great-grandsons of the person who inherits it, acquire an interest, and the rights attached to such property at the **moment of their birth.**
- **Case Law to understand the Concept : -**Thus, if 'A' inherits property, whether movable or immovable, from his father or father's father, or father's father's father, it is ancestral property, as regards his male issue. (AIR 1936 Orissa 331).
- A person inheriting property from his three immediate paternal ancestors holds it, and must hold it, in coparcenary with his sons, son's sons, and son's son's sons. Dipo v. Wassan Singh – AIR 1983 SC 846 at 847-48; The share, which a coparcener obtains on partition of ancestral property, is ancestral property as regards his male issue.

- The incidents of co-parcenership under the Mitakshara law are :

1. The lineal male descendants of a person up to the third generation, acquire on birth ownership in the ancestral properties of such person;
2. Such descendants can at any time work out their rights by asking for partition;
3. Partition each member has got ownership extending over the entire property conjointly with the rest;
4. Result of such co-ownership the possession and enjoyment of the properties is common;
5. No alienation of the property is possible unless it be for necessity, without the concurrence of the coparceners, and
6. The interest of a deceased member lapses on his death to the survivors.

- A **coparcenary** under the Mitakshara School is a creature of law and cannot arise by act of parties except in so far that on adoption **the adopted son becomes a co-parcener with his adoptive father** as regards the ancestral properties of the latter." **SBI v. Ghamandi Ram – AIR 1969 SC 1330**.

PARTITION

- **Meaning :- To divide and distribute assets / property amongst the members of the family is called partition.**

- Now it has to be total and by metes and bounds. It can be oral. However, if in writing would attract stamp duty. **(Refer Bhanwari Devi v. Arvind Kumar & Anr. – AIR 2016 Rajasthan – 198)**. It can be unequal and not in accordance with share of each member. It need be recognised under Section 171 of the Income-tax Act for those which have been hythertofore assessed.

AUGMENTING PROPERTY FOR AN HUF

- The existence of an HUF is dependent on the principles of Hindu Law.
- Since HUF is a creature of law, the term `creation of HUF' is a misnomer.
- It may quite often happen that an existing HUF may not own any property.
- In order to avail benefits of tax planning it is necessary for such an HUF to augment its own property.
- In fact the term colloquially used as `creation of HUF' refers to `creating or augmenting funds for an existing HUF'.

DAUGHTER & THE HUF – NOW

- On and from the commencement of the Hindu Succession (Amendment) Act, 2005 in a Joint Hindu Family governed by the Mitakshara law, the daughter of a coparcener shall :-

1. by birth become a coparcener in her own right in the same manner as the son;
2. have the same rights in the coparcenary property as she would have had if she had been a son;
3. be subject to the same liabilities in respect of the said coparcenary property as that of a son,-

New Section 6 of the Hindu Succession Act.

INCOME TAXABLE BY HUF

- If an HUF contributes fund to the capital of a partnership firm, profit and interest received (from the firm) by a partner who represents the HUF is regarded as HUF income.
- This is because the income in the partner's hands arises on investment of the HUF's funds. However, if the Karta is also paid a salary by the firm for efforts put in by him, such funds would be regarded as the Karta's individual income.
- Investment profit can be regarded as the income of an HUF, particularly in cases where the HUF has paid margin money or deposits for such transactions.

TAX BENEFITS FOR HUF

- The income or wealth of an HUF is taxed separately in the hands of the HUF itself and no part thereof is subject to tax in the hands of any member of the family by virtue of Section 10(2) of the Income-tax Act.

- Since an HUF has been granted the status of an independent tax entity just like an individual, it would also enjoy the advantages of separate personal income-tax exemption limit of Rs.2,50,000 and graded tax structure up to the maximum income level of Rs.10,00,000, deductions from gross total income under Section 80C of the Income-tax Act.

CONCEPT OF FAMILY ARRANGEMENT

Why Family Arrangement is Important now a days?

- In the Indian scenario, often, several unrelated businesses are housed in a single vehicle (such as a common holding company) but are distinctively managed and controlled by different members of family with no interference from the other family members.

- In order to settle such existing disputes or avoid any potential litigation among the family members, such families arrive at a “family arrangement” either by way of a mutually agreed deed for family settlement or in the form of an arbitration award or a court decree.

Purpose of Family Arrangements

The ownership of businesses is sought to be aligned with the family members who manage and control such respective businesses

The umbilical cord between the shareholding of the passive family members and the family holding vehicle is sought to be broken by way of settlement in cash to such passive family members.

HOTCH-POT OF PROPERTIES FOR FAMILY ARRANGEMENT

- In **Arvind Chandulal v. C.I.T. [1983] 140 ITR 241 (Guj.).** there was written deed of family arrangement under which all the parties to the deed forthwith brought into hotch-pot all the movable and immovable properties either belonging to them or standing in their names or being anywhere in their possession and thereafter these were distributed among the members by effecting family arrangement. The Gujarat High Court held that what was put into the family arrangement was HUF property and therefore what the assessee, Arvind, got in the family arrangement was also HUF property.

- Their Lordships observed as under:- “The character of the property, namely the property of a HUF as a joint family property, would not change by virtue of being thrown into the family arrangement and then being re-allotted to them under the family arrangement.

SCOPE OF FAMILY ARRANGEMENT :

- Scope of family arrangement is quite wide and it is always necessary that a party to a family arrangement should have a title of his own. Even if the party to arrangement had no title but, under the arrangement, the other parties relinquish all its claim or titles in favour of such a person and acknowledges him to be the sole owner, then the antecedent title must be assumed and the family arrangement should be upheld.

- This means that even such relative who are not strictly speaking , members of the HUF, can be brought into family arrangement. - **C.I.T. v. R. Poonammal [1986] 28 Taxman 26 (Mad.).**

CONDITIONS FOR ENTERING INTO FAMILY ARRANGEMENT :

A

A dispute must exist between the family members at the time or there should be sufficient possibility of arising of such disputes in near future. Such disputes should be regarding the rights of the family

B

There may be some claims by the members of the family or the outsiders which are required to be satisfied according to the wishes of the family members or outsiders in the interest of maintaining peace in the family

TAX ASPECTS IN FAMILY ARRANGEMENT:

- Family arrangement is mainly a medium for resolving disputes but simultaneously one should take care of the tax aspects.

- Many a times, it is seen that disputes arise on death of the father without any Will. In such cases family arrangement can take the place of Will if the legal heirs agree to divide the assets and liabilities among themselves in a particular manner. In such cases it is advisable to achieve the twin objective of resolution of family disputes and tax planning.

- It is open to the Karta of the family who is single co-parcener with the widowed mother and un-married sisters to allow the properties to the un-married sisters in lieu of the claim of marriage and maintenance through the family arrangement- **C.I.T. v. Narain Dass Wadhwa [1980] 123 ITR 281 (P&H).**

- The clubbing provisions of section 64 of the Income Tax Act are also not attracted to the family arrangement. But one should be careful and cautious. The family arrangement should be bonafide, otherwise it may fail. In a case before the Madhya Pradesh High Court in **S.R. Kalani (HUF) v. C.I.T. [1989] 177 ITR 259(MP),** a partnership was formed by family arrangement giving a lump sum amount to the mother under family arrangement. On the basis thereof, she was admitted as a partner in the firm with the Karta of HUF, her only son.

- Earlier, it was claimed as a partition which was rejected and the family was assessed in the status of HUF as before. Later on the plea of partition was given up and it was claimed that the mother was given a sum of rupees one lakh in lieu of her right to maintenance under the family arrangement. It was found on the facts that the mother did not withdraw any amount for her maintenance. The story of quarrel with her daughter-in-law was also found incorrect because she made a gift of her jewellery to the daughter-in-law after the alleged family arrangement. Thus, the family arrangement was not found to be bonafide and was rejected by the Court.

SAVING OF STAMP DUTY AND TRANSFER EXPENSES

- The expenses on stamp duty and registration charges may be avoided if the Panchnama or Memorandum of Arrangement or any similar document containing proof of division of the family property is registered with the Registering Authority.

- Such registration will provide contemporaneous proof of ownership of respective property by its recipients as per family arrangement.

FAMILY ARRANGEMENT- WHETHER TRANSFER ?

- Family arrangement is not a transfer. A family arrangement, on the contrary, is a transaction between members of the same family for the benefit of the family so as to preserve the family property, the peace and security of the family, avoidance of family dispute and litigation and also for saving the honour of the family. Such an arrangement is based on the assumption that there was an antecedent title in the parties and the agreement acknowledges and defines what that title is. It is for this reason that a family arrangement by which each party takes a share in the property has been held as not amounting to a conveyance of property from a person who has title to it to a person who has no title.

- (Refer : *S.K. Sattar SK Mohd. Choudhari v. Gundappa Amabadas Bukate (1966) 6 SCC 373; CIT. v. A.L. Ramnathan (2000) 245-ITR-494 (Madras.)*

DISTINCTION IN BETWEEN A FAMILY ARRANGEMENT AND A FAMILY SETTLEMENT.

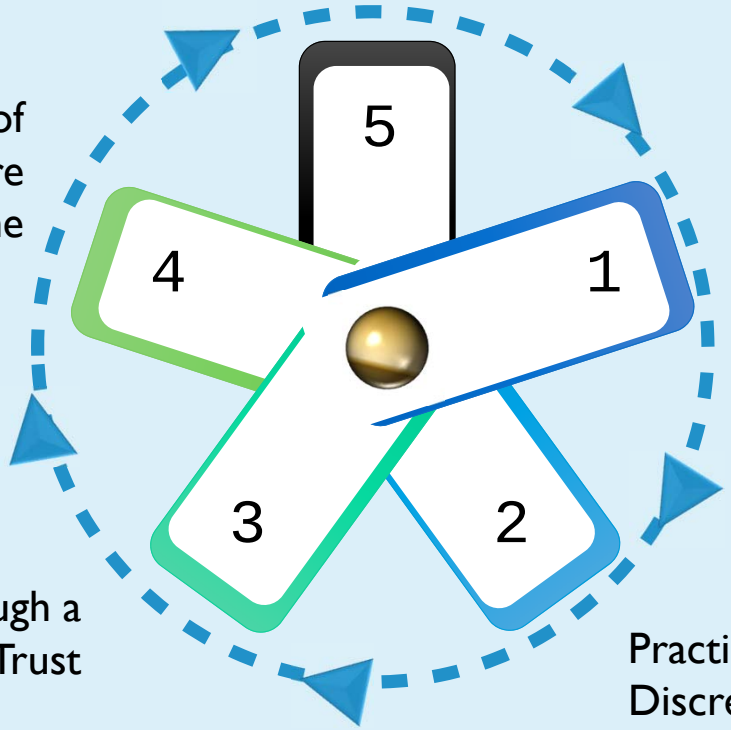
- Where there is family settlement and relinquishment taking away shares of sisters, mother etc. in immovable property, such document needs registration and attracts stamp duty.
- If unregistered would be inadmissible for collateral purposes until same is impound as hold in *Sita Ram Bhama v. Ramavtar Bhama – AIR 2018 S.C. 3057* – Kale and Others were explained and distinguished. Punjab and Haryana High Court in *Hargurusharan Singh v. Lt. Col. Hargovind Singh – AIR 2017 P&H 3* held a family settlement deed as compulsorily registerable when there was no pre-existing right in property and there had been failure to establish genuineness.

TAX PLANNING VIA EXECUTION OF A WILL- TRUST

TAX PLANNING VIA EXECUTION OF A WILL

Distributing properties under a Will

Clubbing of Minor's entire Income



Planning through Creation of a Discretionary Trust under a Will

Tax Saving through a Discretionary Trust

Practical Utility of a Discretionary Trust

DISTRIBUTING PROPERTIES UNDER A WILL

- Through execution of a Will, a person can ensure that useful tax planning benefits are availed of by his legal heirs after his death. It is common to see a testator wishing to distribute his properties amongst close members of his family.

- **For example,** when a father executes a Will, he may want to distribute his properties amongst his sons. At such a time, the father should also keep in mind the taxable income and wealth of his sons. If the sons have taxable income or wealth attracting tax at a high bracket, distribution of assets to them would further increase their income-tax.

- In such a case, if the father distributes such properties under the Will to the sons' wives, sons' children or sons' HUFs, whose taxable income and wealth are either belong taxable and wealth are either below taxable or in a comparatively low tax bracket, this would be extremely useful from the point of view of tax planning.

- Accordingly, any person who is expecting to receive some properties as a beneficiary from the estate of his parents or close relatives should try to ensure that such properties are received by the family members in a low tax bracket.

PLANNING THROUGH CREATION OF A DISCRETIONARY TRUST UNDER A WILL

- A testator should plan the distribution of assets under his Will in such a manner that the persons receiving such properties in the family are either in a zero tax bracket or at a comparatively low tax bracket. However, what can be done, in case the members of the family are in the maximum tax bracket of 31.2%?

- In such circumstances, the testator can avail the benefits of useful tax planning by creation of a Discretionary Trust under his Will. Under the provisions of Section 164 of the Income-tax Act, 1961. Private Discretionary Trust attracts Income-tax at the maximum marginal rate of 31.2%.

- However, in this context, there is an important exception in regard to `One Discretionary Trust created under a Will,' in respect of which the income-tax would be applicable at the normal rates and such an entity would be taxed as a separate and distinct assessable unit.

- A Trust in which either beneficiaries are not determined, or if determined their share in the income or assets of the Trust is not determined, is known as a `Discretionary Trust'. In case of such a Trust, the Trustees are given full rights to distribute the income and assets amongst the beneficiaries at their discretion.

PRACTICAL UTILITY OF A DISCRETIONARY TRUST

- Such a Discretionary Trust created under Will, also has considerable practical utility in a situation where the testator is a very wealthy persons and his assets are to be distributed to minor children who are yet not mature or understanding.
- The concern of the testator in such a case is how the children would be able to manage the large amount of assets.
- In such a case, the testator can create either a Discretionary Trust or in appropriate cases, even a Specific Trust by appointing Trustees, who are his close friends or family well wishes

TAX PLANNING FOR TRANSFER OF FUNDS TO WIFE BY A WILL

- During a taxpayer's lifetime any gifts made to one's wife or vice-versa, are liable to be included in the income of the donor under the provisions of Section 64(1). However, when bequests are made in favour of one's spouse through a Will, obviously there is no question of clubbing of income.

- This can result in a lot of tax saving. With the abolition of the estate duty, this device, as well as other modes of transfer of property through Wills, can be adopted.

TAX PLANNING FOR TRANSFER TO DAUGHTER-IN-LAW BY A WILL

- Under the provisions of Sections 64(1)(vi) and (vii) it is provided that where a transfer is made in favour of the daughter-in-law, either directly or for her benefit to the trustees of a trust, the income from the assets would be clubbed with the income of the donor.
- Hence, during one's lifetime, it is not possible to either make gifts in favour of the daughter-in-law or transfer assets to her through the medium of a trust. This handicap can, however, be overcome through the Will. Thus, a bequest can be made in favour of one's daughter-in-law, so as to confer on her a one, after the testator's demise.
- There would not be any clubbing the income of the daughter-in-law with the income of the executor of the deceased person's estate after the testator's death.

TAX PLANNING BY WAY OF CREATION OF A CHARITABLE TRUST THROUGH A WILL

- A person can fulfil his desire of allocating certain properties for purposes through the Will. He may declare a trust for public purposes and thus transfer the property to the trustees in such a manner that after his demise, the charitable trust so created by Will enjoys the income.
- The drafting of the charitable trust should be such that it enables the trustees of a charitable trust to obtain a complete exemption of income tax under the provisions of Section 11.
- Besides, a taxpayer could also transfer some of his properties to existing charitable trust by way of a bequest in their favour which may be so named in a Will

TAX PLANNING OF A DISCRETIONARY TRUST THROUGH A WILL FOR BUSINESS

- As per the provisions of Section 161(1A), the whole of the income of a private trust through a Will, like in the case of any other trust which on any business, is liable to income tax at the maximum marginal rate.
- However, the proviso to Section 161(1A) provides that where the income of any private specific trust declared by a Will consists of or in clues, any profits or gains of business, the rule regarding the charge ability of income at the maximum marginal rate would not be applicable, provided the trust so declared by any person by Will is exclusively for the benefit of any relative dependent on him for support and maintenance, and provided such a trust is the only trust so declared by him.

CLUBBING OF MINOR'S ENTIRE INCOME

Clubbing of Minor's entire Income

- Clubbing Provision for Minor
- Exceptions to the Clubbing Provisions
- Clubbing of Income with which Parent?
- Exemption of Rs.1,500 per Child
- Important Points to consider for Minor's Income

- Any person who is expecting to receive some properties as a beneficiary from the estate of his parents or close relatives should try to ensure that such properties are received by the family members in a low tax bracket.
- **Example:-** when a father executes a Will, he may want to distribute his properties amongst his sons. At such a time, the father should also keep in mind the taxable income and wealth of his sons. If the sons have taxable income or wealth attracting tax at a high bracket, distribution of assets to them would further increase their income-tax and wealth-tax liabilities.
- In such a case, if the father distributes such properties under the Will to the sons' wives, sons' children or sons' HUFs, whose taxable income and wealth are either belong taxable and wealth are either below taxable or in a comparatively low tax bracket.

PRACTICAL UTILITY OF A DISCRETIONARY TRUST

- Such a Discretionary Trust created under Will, also has considerable practical utility in a situation where the testator is a very wealthy persons and his assets are to be distributed to minor children who are yet not mature or understanding.
- The concern of the testator in such a case is how the children would be able to manage the large amount of assets.
- In such a case, the testator can create either a Discretionary Trust or in appropriate cases, even a Specific Trust by appointing Trustees, who are his close friends or family well wishes.

TAX SAVING THROUGH A DISCRETIONARY TRUST

- Through useful and imaginative planning, a Discretionary Trust under Will can prove to be extremely useful in saving of income-tax, wealth-tax and gift-tax (as applicable up to 30th September, 1998).

- Such a Discretionary Trust under Will also effectively helps in overcoming the `clubbing provisions' under Section 64 of the Income-tax Act.

CLUBBING OF MINOR'S ENTIRE INCOME

History relates to Concepts:-

- As independent income/wealth enjoyed by the minors became a source of envy for the Finance Minister, who while introducing the Finance Bill, 1992 struck a major blow on tax planning for minors by providing that all income/wealth of a minor would be liable to be clubbed with the income/wealth of his parent.

- Section 64(1A) inserted by the Finance Act, 1992 with effect from Assessment Year 1993-94 thus provides that "in computing the total income of any individual, there shall be included all such income as arises of accrues to his minor child."

EXCEPTIONS TO THE CLUBBING PROVISIONS

Two exceptions have been provided in regard to the clubbing provisions. Accordingly, the following income earned by a minor shall be assessed in his own hands and not included with that of his parent:

1. Income derived from manual work done by him.
2. Income derived from any activity involving application of his skill, talent or specialized knowledge and experience (e.g. income of child artistes)

CLUBBING OF INCOME WITH WHICH PARENT?

- It has been provided that the income of the minor will be included in the income of that parent whose total income is greater.
- However, where the marriage of the parents does not subsist, the income of the minor will be includible in the income of that parent who maintains the minor child in the previous year.
- Further, where any such income is once included in the total income of either parent, any such income arising in any succeeding year shall not be included in the total income of the other parent, unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary to do so.

EXEMPTION OF RS.1,500 PER CHILD

- Section 10(32) has been inserted to provide that where the income of an individual includes the income of his minor child under the provisions of Section 64, the individual shall be entitled to exemption of Rs.1,500 in respect of each minor child or the income of such minor includible under section 64, whichever is lower.

- ***Illustration:*** The income of the minor son and minor daughter of an individual for the Financial Year 2019-20 is Rs.30,000 and Rs.10,000 respectively. Considering an exemption of Rs.1,500 each for both the minor children, the balance income of Rs.37,000 (Rs.40,000 – Rs. 3,000) of the two minors will have to be included in the income of the individual.

CLUBBING OF MINOR'S ENTIRE INCOME

Points to consider for Minor's Income

- Income as determined under the Act to be offered for clubbing
- Approrpaite deduction can be claimed in respect of clubbed income
- Credit for TDS
- Whether deduction under Section 80C available to parent in respect of investment out of minor's income?
- Deferring income beyond minority
- Planning Income for Minors through a Discretionary Trust

- **Income as determined under the Act to be offered for clubbing**

The income of the minor to the clubbed in the hands of the individual parent is to be understood with reference to the income as determined in the hands of the minor child by applying all the provisions of the Income-tax Act relating to the computation of income under a particular head or from a particular source. Thus, if an investment has been made in the name of a minor from borrowed funds, the interest paid on such borrowing would be deductible from the investment income and only the balance would be liable to be clubbed with the income of the parent.

- **Approrpaite deduction can be claimed in respect of clubbed income:**

The income of the minor liable to be included with the income of the parent retains the same character even after such inclusion and is accorodingly to be offered under the respective head of income. Consequently, appropriate deduction under the Income-tax Act as may be applicable in regard to such income can be claimed in the hands of the parent. For example, an individual can claim 30% standard deduction out of the rental income of his minor child included in his total income.

- **Credit for TDS:**

As per the proviso to Section 199 of the Income-tax Act, where the income of a minor is clubbed with that of his parent under Section 64, credit for the tax deducted at source (TDS) in respect of such income would be available to the parent in whose case the income is included for purposes of income-tax.

- **Whether deduction under Section 80C available to parent in respect of investment out of minor's income?**

Section 80C of the Income-tax Act provides for deduction to a taxpayer in respect of specified investments and allocations made by him during the relevant previous year. An interesting question that would arise in this context is whether a parent can claim deduction under Section 80C in respect of such investments or allocations made out of the income of the minor child, whch is liable to be clubbed in his hands under Section 64(1A). The Madras High Court has held in `CIT v. V.S. Chelliah' 147 ITR 590 that where the interest income of the wife is clubbed with the income of the husband, the husband is entitled to a deduction under Section 80C in respect of life insurance premium paid by the wife out of income so clubbed.

INVESTMENT OF MINOR'S FUNDS IN TAX-FREE INVESTMENTS

- The impact of the clubbing provisions in respect of minor's income can be effectively blunted by investing the minor's funds in such investments, the income of which is totally free from Income-tax. Thus, investment in a Public Provident Fund (PPF) Account opened in the name of a minor has been a popular mode of capital building in the hands of the minor, since the 7.9% return of PPF being tax free u/s. 10, if effectively escapes the clubbing net. If the parent of the minor in whose case such income is to be clubbed, is in the maximum Income-tax bracket of 31.2%, `the break even rate of interest before tax' on the annual tax free interest yield of 7.9% effectively work out to as high as 11.48%.

- Similarly investing minor's funds in Mutual Fund Schemes, where both the dividend and long term capital gains are tax free and hence the clubbing provisions are rendered ineffective, is another soubd strategy for planning income for minors.

PLANNING INCOME FOR MINORS THROUGH A DISCRETIONARY TRUST

- With a view to ensure building up income for the minors without attracting the clubbing provisions, one of the effective tools is a Private Discretionary Trust.

- **Using the medium of a Discretionary Trust**

A private discretionary trust is a trust wherein the beneficiaries and/or their shares in the income and assets of the trust are not specified in the trust deed. The trustees of such a trust are given full discretion in deciding these matters. The provisions of Section 164 of the Income-tax Act which govern the taxability of a private discretionary trust specify that income-tax shall be charged on the income of the trust at the `maximum marginal rate' (currently 31.2%).

However, the following two important exceptions to Section 164 which provide for change of tax on the income of a discretionary trust at the ordinary rates in the case of an association of persons (i.e. at the same rates as in the case of an individual) merit careful attention:

1. Where none of the beneficiaries of the trust has any other income chargeable to tax (i.e. total income exceeding Rs.2,50,000 effective from FY 2012-13) and none of the beneficiaries is a beneficiary under any other trust.
2. Where the trust is declared by any person under his Will and such trust is the only trust so declared by him.

- Thus, if the discretionary trust falls under either of the above two exceptions, the benefit of a distinct and independent tax entity, liable to tax at ordinary rates, just like an individual, can be availed. Such a trust can play an important role in the arena of tax planning for minors. If minors are made beneficiaries under such a trust and the income of the trust is accumulated at the discretion of the trustees during their minority, no income can be said to accrue or arise to the minor beneficiaries and accordingly such income accumulated for the benefit of the minors cannot attract the clubbing provisions of Section 64(1A) of the Income-tax Act.

- Moreover, as compared to the language of Section 64(1) which provides for inclusion of `all such income as arises directly or indirectly', the language of Section 64(1A) provides for inclusion of `all such income as arises or accrues to the minor child.'

- Thus the words `directly or indirectly' as contained in the clubbing provisions in respect of non-minors under Section 64(1) are missing under the clubbing provisions for minors under Section 64(1A).

- Accordingly, it cannot be argued that the income of the trust in which a minor is a beneficiary is even indirectly attributable to the minor.

Thank You

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