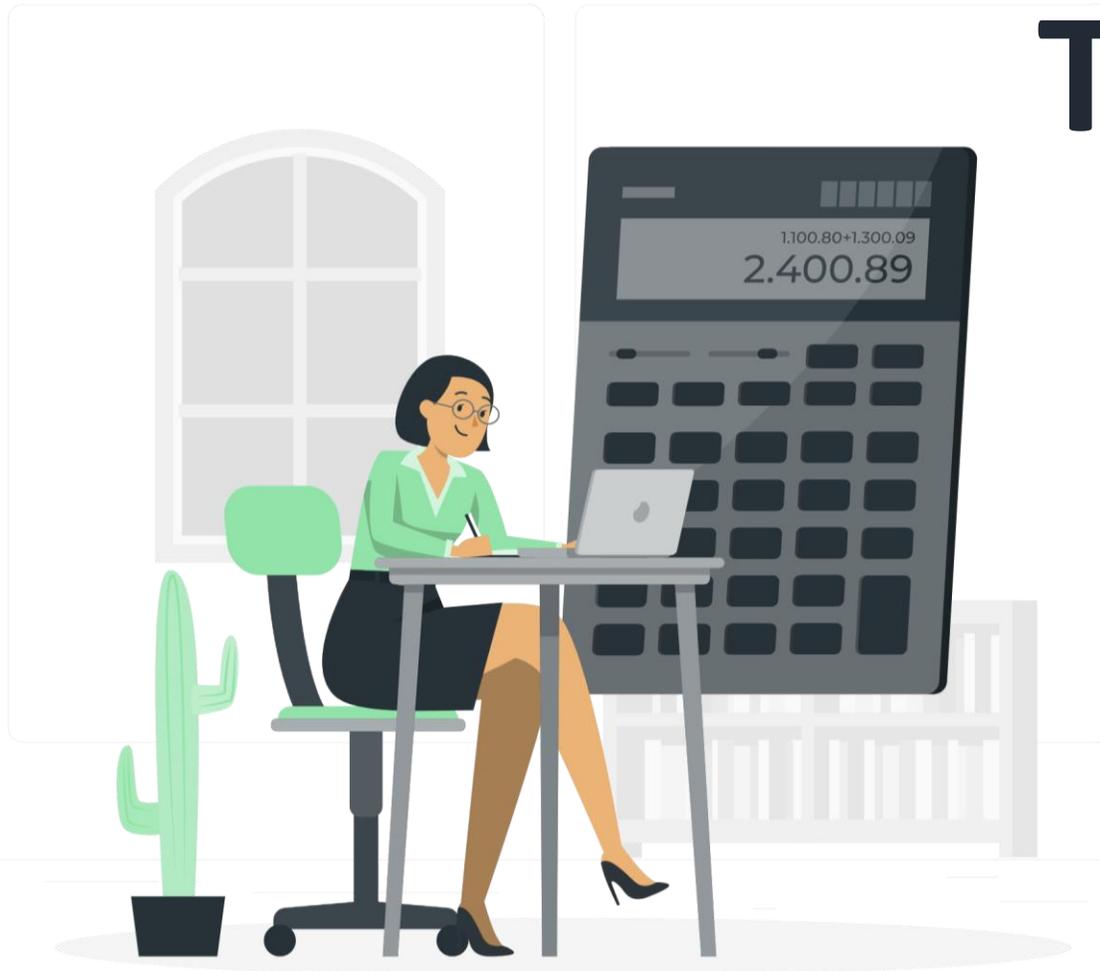




M2K Advisors

Taxation of Trust – Part III

SUCCESSION PLANNING SERIES #27



Status of trust for taxation purposes



Under the **Indian Income tax Act, 1961 ('the Act')**, a person is defined under Section 2(31) to include an individual, a Hindu undivided family ('HUF'), a company, a firm, an association of persons ('AOP') or a body of individuals ('BOI'), a local authority and every artificial juridical person not falling above.

A trust is specifically not covered under the definition of **"person"** under the Act. Further, the taxation provisions specified in **Section 11 to 13** of the Act applies only for charitable / religious trusts and not to private trusts.

It is clear that **a trust cannot be treated as a company or HUF or a firm**. Hence, it is important to evaluate whether the trust can qualify as an individual or AOP or BOI or artificial juridical person.

Landmark rulings on status of a private trust (1/2)

Particulars	Relevant extract of the ruling
Is trust an AOP ?	<p>Supreme Court in the case of CIT vs Indira Balkrishna [1960] (39 ITR 546) held that “The word "associate" means, according to the Oxford Dictionary, "to join in common purpose, or to join in an action." Therefore, <u>an association of persons must be one in which two or more persons join in a common purpose or common action</u>, and as the words occur in a section which imposes a tax on income, the association must be one the object of which is to produce income, profits or gains”. Though this decision is not in the context of trust, the same can be referred to for the purpose of ascertaining the meaning of AOP.</p> <p>Bombay High Court in the case of CIT vs Marsons Beneficiary Trust [1990] (188 ITR 224) held that “<u>The beneficiaries have not come together with the object of carrying on business</u> nor have they authorised the trustees to carry on any business, as was the case in the above decision. The trustees derive their authority to carry on business, not from the beneficiaries, but from the settlor under the terms of the deed of trust. They do not require the consent of the beneficiaries for exercising their authority under the deed of trust. The authority is conferred on them by the settlor. <u>The beneficiaries are mere recipients of the income earned by the trust. They have not come together for a common purpose. They cannot, therefore, be considered as an association of persons or a body of individuals</u>”.</p>
Is trust an BOI ?	<p>Bombay High Court in the case of Lalchand Tikamdas Makhija vs J.K. Kuriyan [1991] (188 ITR 253) held that “<u>Assessment of income of the trust in the status of BOI was not justified.</u> The assessment may be made in the hands of the beneficiaries or in the hands of the trustees but it has to be in the same manner and to the same extent as it would have been made in the hands of the beneficiaries”.</p>

Landmark rulings on status of a private trust (2/2)

Particulars	Relevant extract of the ruling
Is trust an artificial juridical person ?	Madras High Court in the case of Thanthi Trust vs Wealth Tax Officer [1989] (178 ITR 1), in the context of Wealth tax, held that “ <u>It is well settled that a trust is not a juristic person or a corporate person.</u> Further, section 21(1) clearly postulates that wealth-tax shall be levied upon and be recoverable from the manager or the trustee. Section 21(2) gives an option to the WTO to levy tax either on the trustee or the beneficiary. Consequently, in the present case notice under section 17(1)(a) itself, having been addressed to the trust, was invalid”.
Is trust an individual ?	Supreme Court in the case of Commissioner of Wealth Tax, Andhra Pradesh vs Trustees of H. E. H. Nizam's Family (Remainder Wealth) Trust [1977] (108 ITR 555) held that “ <u>The status of the trust would be based on the status of the beneficiaries of the trust</u> ”. Thus, if all the beneficiaries of the trust are individuals, then such trust would be assessed as an individual assessee. Further, in the context of private discretionary trust, the CBDT vide circular no. 6/2012 dated 03 rd August 2012, provided that the status of a private discretionary trust has been held in law as that of an ‘individual’.



In a case where the beneficiaries comprise of a combination of individuals and non-individuals, how will the trust be assessed ?

Taxation of trusts



- Section 160(1)(iv) provides the definition of representative assessee and it provides that in the case of a trust declared by a trust deed, the trustee shall be the representative assessee.
- Section 161 of the Act provides that every representative assessee (i.e., the trustee) shall be assessed in respect of income of the trust **in the like manner and to the same extent** as that of the beneficiaries and such assessment shall be deemed to be made upon him in **his representative capacity only**.
- However, the total income of the representative assessee shall be subject to tax at **Maximum Marginal Rate*** ('MMR') if the total income of the trust includes **Business income**. The only exception to such taxability is when Business income is earned by a trust, declared by a person under a Will exclusively for the benefit of dependent relatives and such trust is the only trust so declared by him.
- Section 162 of the Act provides the right to a representative assessee to recover the tax paid from the person on whose behalf it was paid.
- In a case where the share of the beneficiaries are indeterminate or unknown (i.e., discretionary trust), then the representative assessee shall be subject to tax at MMR (Section 164).
- Further, Section 166 provides the Assessing Officer an option to directly assess the beneficiaries with respect to income received by the trustees on behalf of the beneficiaries.

** MMR means the rate of income-tax (including surcharge) applicable in relation to the highest slab of income as specified in the Finance Act of the relevant year.*

Principles with respect to taxation of specific trust



- The Apex Court in the case of **Commissioner of Wealth Tax vs Trustees of H. E. H. Nizam's Family (Remainder Wealth) Trust** [1977] (108 ITR 555) held that the trustee is assessable in the like manner and to the same extent as that of the beneficiary and provided the following principles with respect to the manner of taxation of a specific trust.
 - There would have to be as many assessments on the trustee as there are beneficiaries with determinate and known shares, though, for the sake of convenience, there may be only one assessment order specifying separately the tax due in respect of the wealth of each beneficiary.
 - Secondly, the assessment of the trustee would have to be made in the same status as that of the beneficiary whose interest is sought to be taxed in the hands of the trustee.
 - Lastly, the amount of tax payable by the trustee would be the same as that payable by each beneficiary in respect of his beneficial interest, if he were assessed directly.
- In a case where income of the trust has been assessed in the hands of the trustee in the capacity of a representative assessee, the same income cannot be assessed again in the hands of the beneficiary (as per CBDT circular no. 157 dated 26 December 1974).

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THANK YOU

Chennai - India

M2K Advisors LLP

7th Floor, Briley One,
No. 30/ 64 Ethiraj Salai,
Egmore, Chennai – 600 008,
Tamil Nadu, India

Hyderabad - India

M2K Advisors LLP

Manjeera Trinity Corporate
JNTU Road, Plot No S2 ,
Telangana- 500072
Hyderabad

Singapore

M2K Advisors Pte Ltd

The Octagon,
105 Cecil Street, #13-02
Singapore 069534

USA

M2K Sai Advisors Inc

1 AUER CT,
2nd Floor, East
Brunswick
New Jersey - 08816

UAE - Dubai

M2K Advisors

701 C Aspin Commercial
Tower, Sheikh Zayed Road,
Trade Center First, Dubai
PO Box - 50810

Reach us at:

knowledge@m2k.co.in



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