



M2K Advisors

Taxation of Trust

Part 5 - Case Laws

SUCCESSION PLANNING SERIES #29



Preface

In our previous alerts, we have discussed about how the private trusts and the parties to trust are taxed in India and how the status of trust is determined for assessments.

In continuation to our previous series, in the series #29, we will be going through certain landmark rulings to have a better understanding and clarity on how the trusts will be characterized for taxation aspects under certain circumstances.

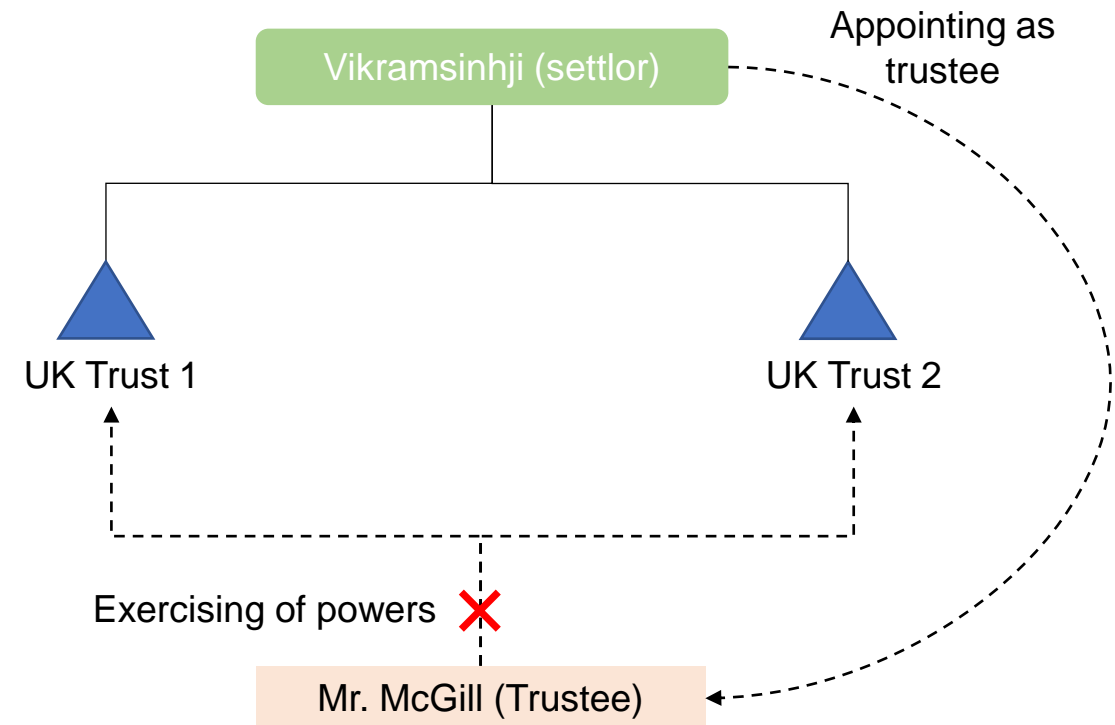


CIT, Rajkot vs. Estate of Late HMM Vikramsinhji of Gondal (Civil Appeal No. 2312 of 2007)(1/2)

Issue : Whether the characterization of private discretionary trust would change when the trustees fail to exercise their powers as defined in the trust deed.

Facts

- The taxpayer was the eldest son of Vikramsinhji (settlor) and the settlor had executed three trust deeds in USA and two trust deeds in UK for the benefit of the taxpayer and the members of his family. He had appointed Mr. McGill as the trustee for the UK trusts.
- The settlor and the taxpayer were declaring the entire trust's income as taxable in India for initial years. Post that, the taxpayer did not report any income in India. The Assessing Officer (AO) passed an order taxing the income of the trusts in the hands of the taxpayer like the previous years. The Appellate Tribunal also held that the income was taxable like the previous years.
- The Settlement Commission held that the UK trusts were specific as it contained certain clauses in the trust deed about powers of the trustee. On further appeal to the Supreme Court, the Supreme Court held the judgement as specified in the next slide.



CIT, Rajkot vs. Estate of Late HMM Vikramsinhji of Gondal (Civil Appeal No. 2312 of 2007)(2/2)



Judgements

If a private trust is settled/ created as discretionary trust by vesting trustees with power to distribute the income of the trust to the beneficiary and the trust deed contains a clause with respect to appointment of additional trustee in case the trustee fails to exercise his powers. Even if the trustees do not exercise such powers for several years, the trust would still be treated as a discretionary trust since the income has been retained by the trust and not distributed to the beneficiaries.

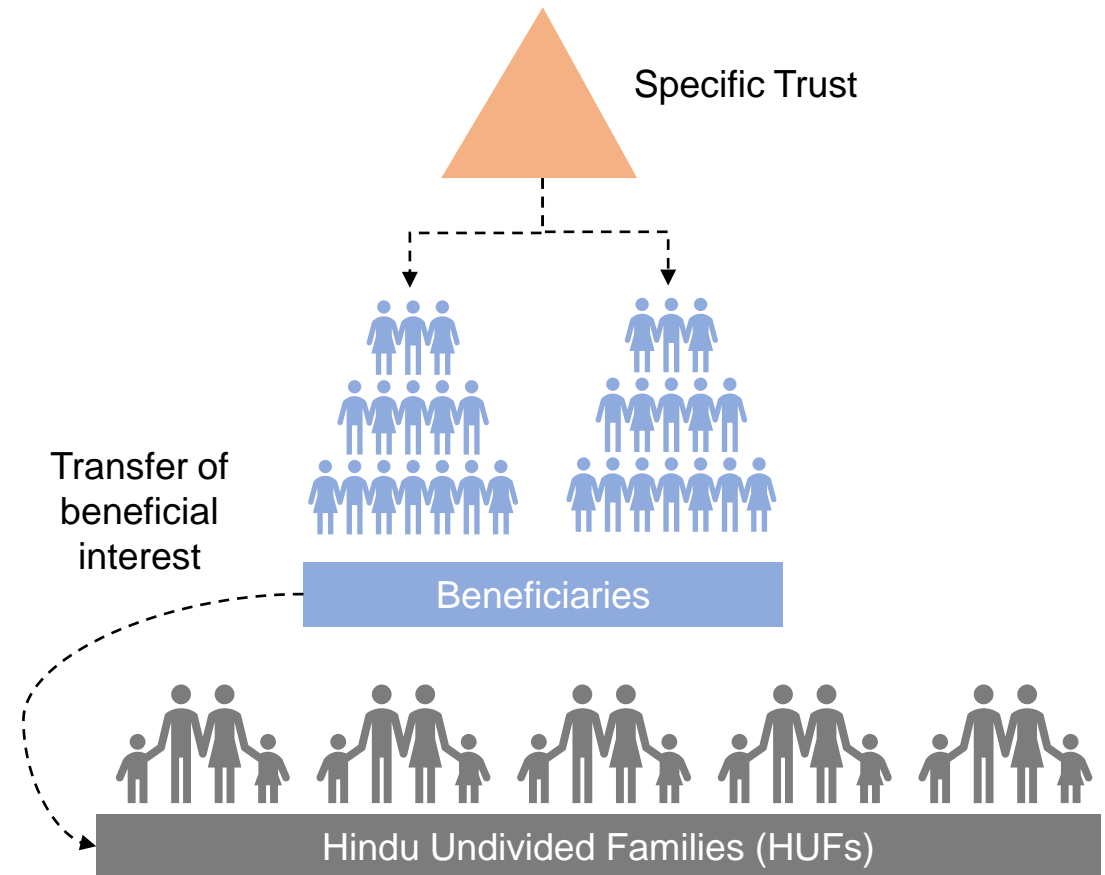
Despite the trust deed containing such clauses, it would still be treated as a discretionary trust and not as specific trust. The character of the trusts does not get altered, due to the mere fact that the settlor or his legal heir did not exercise their power to appoint additional trustee as the trustee failed to distribute the income. **The beneficiary thus has no more than a hope that the discretion will be exercised in his favour.** Thus, the UK trusts are to be assessed as discretionary trusts and accumulated income of such trust can be taxed in the hands of the beneficiaries only when they are actually distributed and cannot be taxed on accrual basis.

Kashiba Family Trust Vs. Income-Tax-Officer [ITAD Ahmedabad] [1986] 15 ITD 383 (1/2)

Issue: Where the beneficiary transfers its beneficial interest/ right in the specific trust to new beneficiaries, whether the same would result in trust to be assessed as indeterminate trust.

Facts

- The trust had 21 beneficiaries whose shares in the trust are determinate and specified. For the AY 1978-79 to 1981-82, the ITO had framed the assessments in the hands of the trust u/s 161 treating it as a specific trust.
- On 19-10-1981 five of the beneficiaries transferred their beneficial interest in the trust to five different HUF as new beneficiaries. For the AY 1982-83, the ITO accepted the trust's claim and assessed it as specific trust accordingly.
- The CIT, however exercising his powers u/s 263, held that the trust was a discretionary trust as the new beneficiaries had not been specified as beneficiaries and held that assessment was erroneous— and it was prejudicial to the interests of the revenue because the Explanation to section 164 was clearly attracted in the trust's case.



Kashiba Family Trust Vs. Income-Tax-Officer [ITAD Ahmedabad] [1986] 15 ITD 383 (2/2)

Judgements

- The beneficiary has a right to assign his interest in a trust*. In the instant case, the shares of the beneficiaries were determinate and specified, as surrender of such beneficial interest by the beneficiary merely accelerates the interest of the next beneficiaries and will not make the shares of beneficiaries indeterminate.
- Due to the mere fact that there was a change in the beneficiaries, it will not lead to change in the character of the trust and the trust will continue to be assessed as specific trust.
- Vide Circular No 281 dated 22-09-1980 issued by the CBDT, an Explanation was inserted in Section 164 with effect from 1-4-1980 providing in effect that a trust shall be treated as a discretionary trust where the names of the beneficiaries are not identifiable as such on the date of the trust deed. Also, it clearly states that the Explanation inserted in section 164 would be applicable to only those trusts which are discretionary in nature and not the trusts which are specific. Thus, the provisions of the section 164 will not be attracted.



*The decisions of the Supreme Court in the cases of *CIT v. Smt. Kasturbai Walchand Trust* [1967]63 ITR 656 and *CIT v. Nawab Mir Barkat Ali Khan Bahadur* [1974]97 ITR 246

Sanjiv Family Trust vs. Income-tax Office [ITAT AHMEDABAD] [1993] 46 ITD 577 (1/3)

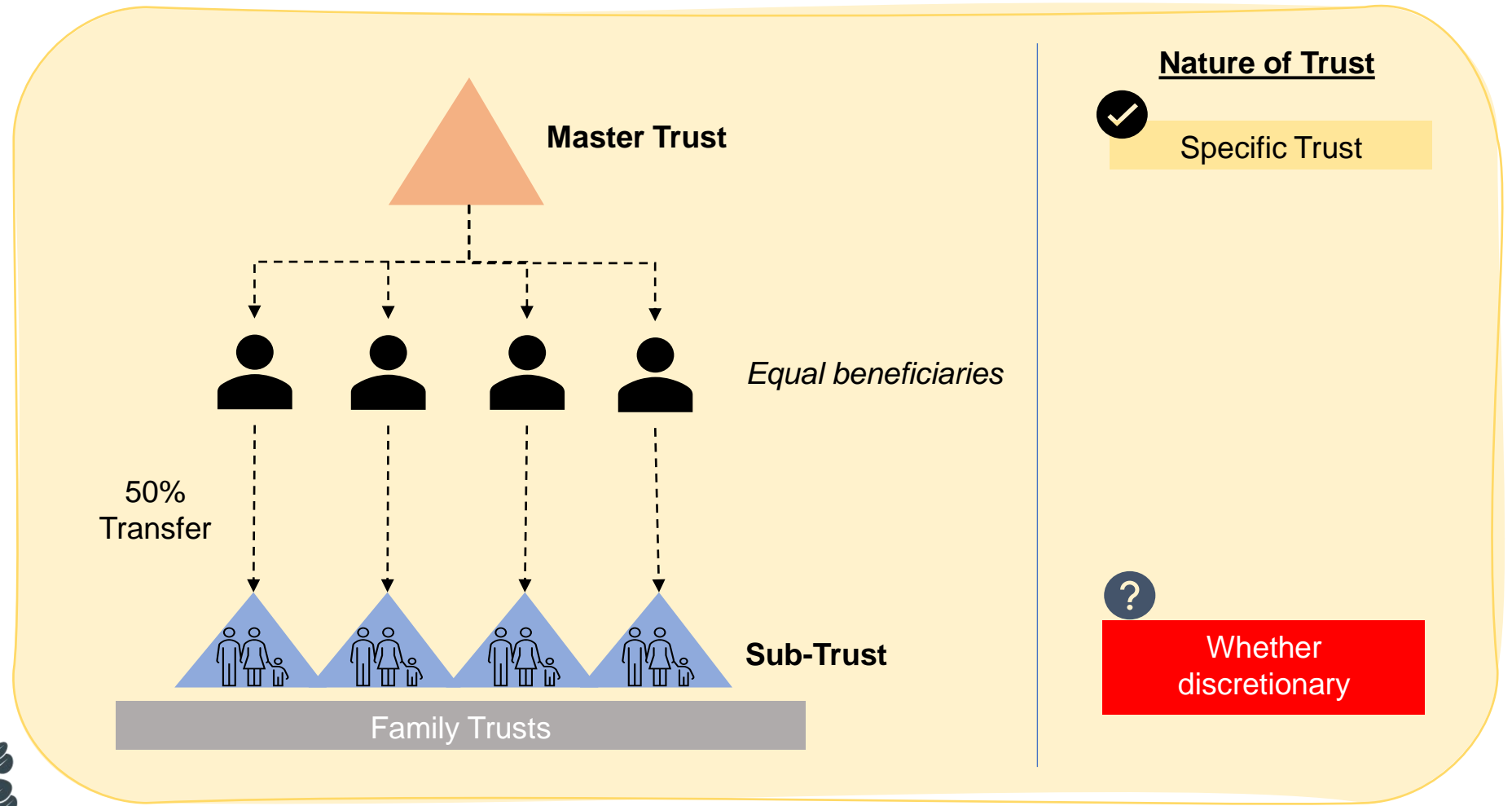
Issue: How the sub-trusts would be assessed and taxed in case of assignment of beneficial interest by the beneficiaries of master trust to the sub-trusts.

Facts

- The private family trust was created by the deed of settlement with four individuals as equal beneficiaries. For the AY 1983-84 it was treated as a specific trust as the beneficiaries and their shares were specified and were determinate.
- The position for the assessment year 1984-85 was different. On 13-3-1984 each of the four original beneficiaries transferred half of his respective beneficial interests to other family trusts for consideration. It was further found that the assignee-family trust (second level trusts) in turn had BOIs as beneficiaries which had come into effect on 9-3-1984.
- The inter se shares of the individuals constituting the BOIs were not specified and the deed gave discretion to distribute as the person concerned pleased. The Assessing Officer contended that after the said assignments, the ultimate beneficiaries were the members of the BOIs and their individual shares were indeterminate. Hence, the trust should be assessed as discretionary trust for the AY 1984-85 and is liable to be taxed at MMR.



Sanjiv Family Trust vs. Income-tax Office [ITAT AHMEDABAD] [1993] 46 ITD 577 (2/3)



Sanjiv Family Trust vs. Income-tax Office [ITAT AHMEDABAD] [1993] 46 ITD 577 (3/3)

Judgements

- The trust was a discretionary trust with respect to the income that stood assigned to the second level trusts. Only the assigned parts of the income would suffer tax in the hands of the main trusts at MMR and the unassigned parts would continue to be allocated amongst the specified beneficiaries.
- As regards the question regarding multi-taxation in the cases of second level trusts, the same were discretionary trusts and were liable to be taxed at MMR but due to the cardinal principle of avoiding double taxation the amounts, the same would not be taxed again in the hands of the second level trusts.
- So far as the assessment of the BOIs was concerned, the incomes or parts of income which had been brought to tax in the hands of main trusts or the second level trusts at MMR would not be again taxed in the hands of BOIs.



Succession Knowledge Series - Please find below the list of completed alerts from the series. In case you have missed the previous alerts, click on the hyperlink for the completed alerts to refer the same.



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