



M2K Advisors

Taxation of Trust – Part I

SUCCESSION PLANNING SERIES #25



Brief taxation of Private Trust

01

The taxation of Private Trust is an intricate and complex issue. Despite various rulings, there is still a lot of ambiguity with respect to many aspects.

02

A Trust is not considered as a separate taxable entity as section 2(31) of the Income Tax Act, 1961 ('the Act') does not include a Trust under the scope of definition of the term "person".

03

Private Trust is taxed in a special manner through the taxation of trustees. Under the Income Tax Act, trustees and beneficiaries are regarded as assessee and the income of the trust is taxed either directly in the hands of the beneficiary or in the hands of trustees as representative assessee (i.e., representative of beneficiaries).

04

For taxation purposes, a trust can be classified into two types viz - Specific trust and Discretionary trust. Refer our upcoming series for detailed discussion on the same



Taxability of the settlor on transfer of assets



Section 47(iii) of the Act exempts the settlor from taxation of any gains arising on transfer of capital asset under an irrevocable trust.

01

In the case of a revocable trust, clubbing provisions would apply and the income arising by virtue of revocable transfer of assets shall be chargeable to tax in the hands of the transferor / settlor.

02

The above provisions are only for the purposes of taxability of the transfer and does not in any way affect the contractual rights and obligations as may be prescribed in the trust deed.

03

Clubbing provisions under the Income tax Act



- All income arising to any person by virtue of a revocable transfer of assets shall be chargeable to tax as if it were the income of the transferor and shall be included in the total income of the transferor.
- **A transfer shall be deemed to be revocable if:**
 - It contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or the assets to the transferor or
 - It, in any way, gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income or assets.
- There is no requirement for an actual retransfer or actual re-assumption of power. If the trust deed contains any provision wherein the income or asset can be retransferred back to the settlor or power can be reassumed by the settlor, the same would still be treated as a revocable transfer.
- However, the income earned from the assets transferred shall not be included in the total income of the transferor if the trust is not revocable during the lifetime of the beneficiary.

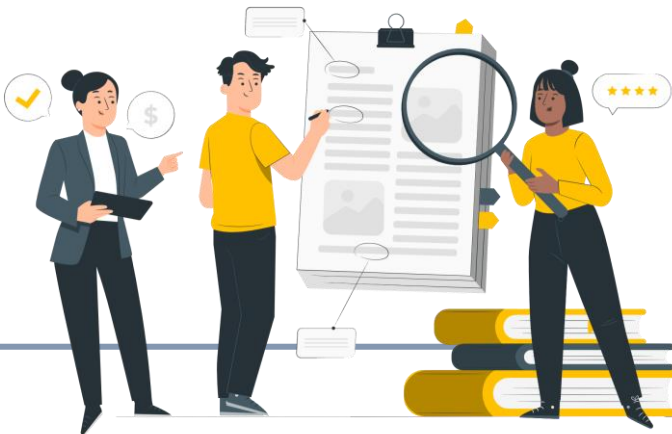


Comparison of important clubbing provisions

Income tax Act, 1922

Sec. 16(1) In computing the total income of an assessee (c) all income arising to any person by virtue of a revocable transfer of assets shall be deemed to be income of the transferor:

Provided that for the purposes of this clause a settlement, disposition or **transfer shall be deemed to be revocable if it contains any provision for the retransfer directly or indirectly of the income or assets to the settlor**, disponent or transferor, or in any way **gives the settlor, disponent or transferor a right to reassume power directly or indirectly over the income or assets.**



Income tax Act, 1961

Sec. 61. All income arising to any person by virtue of a revocable transfer of assets shall be chargeable to income-tax as the income of the transferor and shall be included in his total income.

Sec. 63. For the purposes of sections 60, 61 and 62 and of this section

(a) a transfer shall be deemed to be revocable if

(i) it contains any provision for the **re-transfer** directly or indirectly of **the whole or any part of the income or assets to the transferor**, or

(ii) it, in any way, gives the transferor a **right to re-assume power** directly or indirectly over **the whole or any part of the income or assets.**

(b) "transfer" includes any settlement, trust, covenant, agreement or arrangement.

Case laws relating to revocability

CASE LAW 1:

In the context of the Income tax Act, 1922, it was held by the Supreme Court in the case of **CIT vs Hrishikesh Ganguly (SC) [1971] (82 ITR 160)**, that only that part of the income which accrued or was received by the settlor could be assessed as his income. The income accruing to other beneficiaries could not be included in the total income of the settlor. The relevant extracts from the judgement is as follows:

“We may also refer to the significant change made in the language with regard to revocable transfers in the Income-tax Act.....It can well be said that the **necessity for expressly mentioning "part of the income" was felt** because under the existing provisions of the Act, “part of the income” was not covered”.

CASE LAW 2:

Where a trust deed contained a clause to the effect that, if the marriages of the settlor's children did not take place within 20 years of settlement, the properties settled on trusts would revert to the settlor.

It was held that such clause would operate only on the failure of the operation of the settlement and not till then. Therefore, Section 61 could not be invoked so long as the trust was not revocable. [CIT v Chandrakanth (M.K.) (1997) 225 ITR 101 (Madras HC)]



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4. [Rules of Intestate Succession Male - Part 1](#)
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