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CERTIFIED PRIVATE BANKING MANAGER®

Session - 3

Concept of Trust – why it should replace HUF.

CONCEPT OF TRUST

- A legal obligation cast on Trustees by the Settlor to exercise the Trust Property in favour of beneficiaries.

- 3 Essentials of a Trust:
  - Obligation-object of Trust
  - Beneficiary–Subject of Trust
  - Trust Property

- Dominium – Perfect and complete ownership. Comprises:
  - Right to Use
  - Right to Enjoy
  - Right to Dispose

- Where right to Dispose is given to one, right to use to second and right to enjoy to third – a Trust exists.

THREE CERTAINTIES OF THE TRUST

- Three Certainties of the Trust
  - Intention
  - Subject Matter
  - Object

THREE CERTAINTIES OF THE TRUST

Certainty of intention:

- Certainty of the intention on the part of the Settlor to create Trust
- Words used:
- No particular words used – no technical words required
- Imperative words
- Trust may be created without using the word “Trust”
- Depends on the construction of the language

THREE CERTAINTIES OF THE TRUST

Certainty of Subject Matter:

- Interest in Land
- Chattels
- Money
- Chose in action
- General Rule: The property subject the Trust must either be clearly defined or be capable of ascertainment.

THREE CERTAINTIES OF THE TRUST

Certainties of Objects:

- Trust must be for human beneficiaries
- Ascertainable beneficiaries is a must for a trust other than charitable trust
- Lack of certainty of object: Trust will be void
- The beneficiaries must be identifiable; they can be given their appropriate shares for their beneficial interest.
- Objects of the Trust: Human
- Wife/girlfriend
- Children/Mother/Father/Brother/Sister
- Best Friends
- Nephew and Nieces

THREE KINDS OF UNCERTAINTY

- Semantic, conceptual or linguistic uncertainty
- Evidential uncertainty
- Administrative uncertainty

ROLES IN A TRUST

Settlor

- Places asset/property in the trust
- Sets up rules for operating the trust
- Sets up rules for winding up the trust
- May establish trust while alive or through a will

The Trust

Assets registered in

Trust May earn income

Trustee

Follows the Trust Agreement

Manages Assets

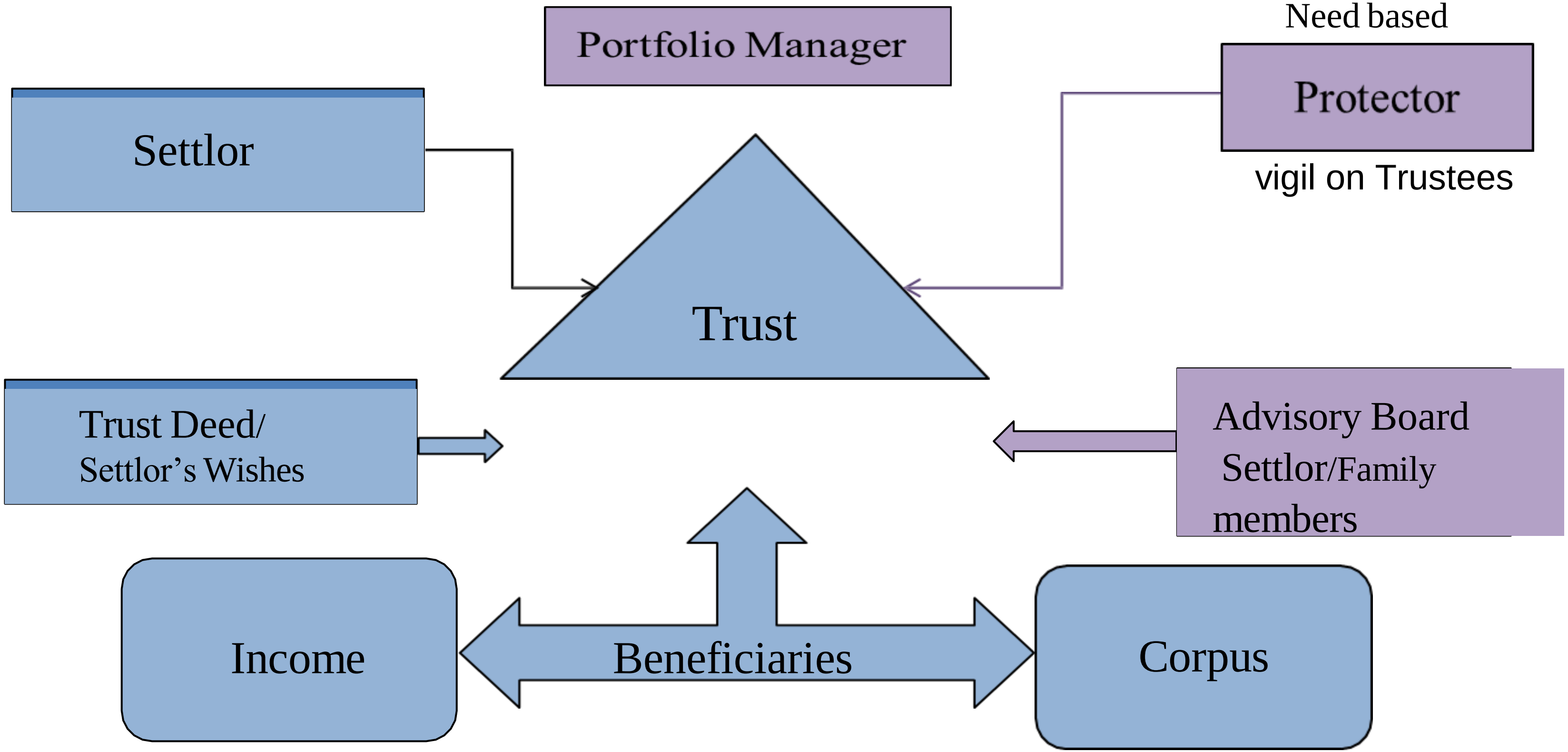
Files Income tax

Beneficiaries

May receive Trust Income

May receive Trust property/assets

TRUST DIAGRAM



TYPES OF TRUST

- **Bare Trust:** A Trust where the beneficiary is absolutely entitled to the assets and the Trustee is obliged simply to pay them over to the beneficiary.
- Resulting and Constructive Trust are usually bare Trusts. Bare Trusts generally do not continue for any length of time, unless they arise out of protracted litigation, or the beneficiaries are minors (in which case the trust must continue till they reach majority).
- **Constructive Trust:** It is imposed by Law as an equitable remedy. It generally occurs due to some wrong-doing. Where the wrong doer has acquired legal title to some property and cannot in good conscience be allowed to benefit from it.
- **Resulting Trust:** It is a form of implied Trust which occurs where a trust fails, wholly or in part, as a result of which the settlor becomes entitled to the assets.

TYPES OF TRUST AND THEIRUSES

- **Simple Trust**: Trustee is just passive depository of the Trust property. No active duties expected from Trustee & no directions are given to him.
- **Special Trust –** Trustee is active and acts as an agent to execute the Grantor's wishes. This Trust is operative.
- **Private Trust –** Settlor creates a Trust primarily for benefit of one or more particular individuals as its Beneficiary.
- **Public Trust –** Beneficiaries are the general public or a class as a whole. It has some charitable end as its Beneficiary.
- **Express Trust –** Here, the Settlor creates a Trust over his assets either in present or upon his death. It can be either by way of a will or Trust deed.
- **Implied Trust –** It is created where some legal requirements for an Express Trust are not met, but intention on behalf of the parties is to create a Trust that is presumed to exist.

TYPES OF TRUST

- **Intervivos Trust:** A Settlor who is living at the time the trust is established creates an intervivos trust.
- **Testamentary Trust:** A Trust created in an individual's will.
- **Irrevocable Trust:** It is one that will not come to an end until the terms of the trust have been fulfilled.
- **Revocable Trust:** A trust of a kind can be revoked (cancelled) by its Settlor any time.

TYPES OF TRUST

- **Discretionary Trust:** An arrangement where the Trustee may choose:
  - Whether to distribute
  - Who to distribute?
  - At what time to distribute?
  - How much & in what proportion to distribute?

  The purpose of such trust is that no individual can claim to be the entitled to any specific interest in the Trustees assets.

- **Fixed Trust:** The entitlement of the beneficiaries is fixed by the Settlor. The Trustees have little or no discretion. For example:
  (a) A Trust for a minor (to X if she attains 21)
  (b) A life Interest (to pay the income to X for her lifetime)

- **Hybrid Trust:** Combines elements of both fixed and discretionary Trusts.

PRIVATE TRUST

- May be created inter vivos or by testament.
- Governed by the provisions of the Indian Trust Act 1882 and the Trust Deed only.
- Specified individuals or a class of individuals are the beneficiaries.
- Under Sec 14 of Transfer of Property Act – can't be for perpetuity.

LEGISLATIONS IN INDIA GOVERNING TRUSTS

- The Indian Trusts Act,1882
- Charitable and Religious Trusts Act, 1920
- Religious Endowments Act, 1863
- Charitable Endowments Act, 1890
- The Societies Registration Act, 1860

Apart from these central legislations, a number of statute have been enacted by the State Legislature dealing with religious and charitable trusts and endowments, for example;

- The Madras Hindu Religious & Charitable Endowments Act (19 of 51)
- The Bombay Public Trusts Act (29 of 1950)
- The Orissa Hindu Religious Endowments Act (4 of 1939)
- The Bihar Hindu Religious Trust Act (1 of 1951)

DIFFERENCE BETWEEN TRUSTS AND FOUNDATIONS

TRUSTS	FOUNDATIONS
Not a separate Legal Entity	Separate Legal Entity
The legal rights and obligations sit with the trustees rather and the trustee therefore contracts on behalf of the trust.	Can contract and hold assets in its own name
Legal ownership of the trust fund sits with the trustees and beneficial ownership with the beneficiaries.	It holds the legal and beneficial title to the assets.
The trustees would sue and be sued in their own name, as opposed to action being taken by or against the trust.	It can sue and be sued in its own name.

WHY HAVE TRUSTS

- Avoid the need for Probates.
- Accommodation to the different personal and juridical laws applicable to various family members.
- Segregation of Beneficial ownership from Legal ownership.
- Maintaining confidentiality of financial transactions.
- Pursuing Philanthropy.
- Maintaining intra and inter generational family control on business.
- Provision for foster children or children with special needs.
- Can be used for the benefit of minor children.
- Ensure use of your wealth in case of incapacitation.
- Bankruptcy remote.
- Creation of a family fund

FAMILY TRUSTS: ADVANTAGES AND LIMITATIONS

- **Advantages**
  - If properly structured, can provide income flexibility.
  - Asset Protection
  - Estate duty – may not apply.
  - Continuity of Trust beyond life
  - Minimum chances of dispute.
- **Limitations**
  - Loss of Control
  - Unless the Trust is revocable, there will be a limitation on usage of Trust assets.
  - If revocable – no asset protection and estate duty may apply.
  - Costs of continuous maintenance
  - Trust will only not take care of assets continued to be held personally.

RECENT DEVELOPMENTS WORLDWIDE

PERPETUAL TRUSTS

- Perpetual trust refers to a trust that can continue as long as the need for it continues.
- It can be for the lifetime of a beneficiary or the term of a particular charity.
- It can also be a trust for descendants which is intended to remain in existence for as long a term as is permitted under the rule against perpetuities.

RECENT DEVELOPMENTS WORLDWIDE

- **PURPOSE TRUSTS**
  - A purpose trust is a trust which has no beneficiaries and is instead established for a specified purpose.
  - Under common law principles, a purpose trust will be declared void and struck down. This is because only legal persons are capable of possessing rights that attach to a trust, and the lack of beneficiaries of a purpose trust makes it difficult to determine who might be able to enforce equitable rights against the trustees.
- **Exception I - Charitable Trusts**
- **Exception II - Trusts Of Imperfect Obligation**
- **Private Benefit**

RECENT DEVELOPMENTS WORLDWIDE

STAR TRUSTS

- The Special Trusts (Alternative Regime) Law 1997 (the initial letters of which give us the name, "STAR Trust"), now incorporated into Part VIII of the Trusts Law (Revised), introduced STAR Trusts into the law of the Cayman Islands.
- STAR Trusts are established for the benefit of persons, purposes or both. The purposes can be of any or kind or number (provided that they are not contrary to public policy, or illegal).
- The most significant innovation of the STAR trust is the introduction of the role of an "Enforcer".
- The Enforcer is tasked with enforcing the STAR Trust, bringing about a separation between enjoying the benefit of the Trust assets, and being responsible for the Trust's enforcement.
- It is only the Enforcer (or the Court) who has the power or the duty to enforce the STAR Trust.

RECENT DEVELOPMENTS WORLDWIDE

VISTA TRUSTS

- The Virgin Islands Special Trusts Act 2003 as amended (“**VISTA**”) created a statutory trust. The purpose of a VISTA trust is to hold shares in a BVI incorporated company which is not a licensed or regulated company. Few key features of a Vista Trusts are:
- The trustee's duty to supervise the management of the underlying company and to intervene in its running can be removed or modified.
- The trustee may retain the shares indefinitely or only dispose of them with the consent of the directors of the company or other persons named in the trust deed.
- The trust deed may specify certain circumstances in which a beneficiary or other named people may require the trustee to intervene in the management of the company under an "Intervention Call".
- The rule in Saunders v Vautier, which may lead to the beneficiaries of a trust being able to wind it up, can be specifically disapplied for up to 20 years.

RECENT DEVELOPMENTS WORLDWIDE

PROTECTORS AND ENFORCERS

- The role of protector will imply a level of further review to ensure the trustees are acting in the best interests of the beneficiaries through oversight of their proposed actions and administration, and the exercise of consensual and sometimes active powers.
- An enforcer is a rather different role and exists in the context of non–charitable purpose trusts where the trust instrument must provide for a person, different to the trustee, whose duty it is to enforce the trust in relation to its non-charitable purposes.

RECENT DEVELOPMENTS WORLDWIDE

Reasons why Settlor wish to appoint a Protector

- Allows a great degree of flexibility when dealing with changes, including both factual circumstances (death, premature divorce) and legal changes
- Create a Balance of Power to enable Beneficiaries to claim their rights without going to Courts.
- Wishes that certain powers may be withheld from the Trustee. Protector to be SPOC between Trustees and beneficiaries
- May be concerned that the Trustee may not pay sufficient attention to his wishes

RELEVANT INCOME TAX PROVISIONS RELATED TO THE TRUST

1. Section 5 – defines the scope ofincome.
2. Section 11 – Tax exemption for income of Charity Trust if it complies with the rules.
3. Section 12 A – Specifies registration & other conditions for a Charity trust to avail Tax exemptions.
4. Section 13 – Specifies conditions under which tax exemption may not be claimed by a Charity Trust.
5. Section 13B – Provisions regarding receipt of contributions by Electoral Trusts
6. Section 47(iii) – W.r.t Sec 45, transfer of a capital asset under a Will, gift or an irrevocable trust exempt from the definition of Transfer.
7. Section 49(iii)(d) – provides for cost calculation mode in case the asset is acquired by assessee under a transfer to a revocable or irrevocable trust.
8. Section 56(2)(x) – provides for taxing receipt without any consideration of any nature by a person and exempts the receipts by Trusts registered u/s 12A, 12AA and family trusts.
9. Sections 60-63 – when a Trust may be treated as revocable.
10. Section 133 A – States that the ITO can conduct surveys under section 133A on trustees and places of activity for charitable purpose.
11. Section 139 A - Mandatory Requirement of obtaining PAN for the Trustees.
12. Chapter 15 - Section 160-165 – Conditions under which Trustee of trust are taxed as Representative Assessee of the beneficiaries and charging of tax.
13. Section 166 - Choice for AO to assess either the representative assessee or to the person whom he represents.

CASE LAWS

1. **CIT Vs. ANDHRA CHAMBER OF COMMERCE (1965) 55 ITR 722 (SC) -** Definition of the term Charitable Purpose is inclusive and not exhaustive. The expression is not restricted to the objects beneficial to whole mankind. An object which is beneficial to a section of the public is also a charitable object.

2. **CIT Vs. BAR COUNCIL OF MAHARASHTRA (1981) 130ITR 28 (SC) -** The expression advancement of "general public utility" includes any object beneficial to the public or a section of the public as distinguished from an individual or a group of individuals.

3. **Commissioner of Income Tax, Bombay City-II Vs. Walchand Diamond Jubilee Trust [1958]34ITR228 (Bom) -** It was held that if the object of the trust was to benefit the employees of a particular concern or the children of the employees of a particular concern then the trust would not be a charitable trust within the meaning of Section 4(3)(i) of the Act.

CASE LAWS

1. **Cecil Libovitz Vs. Official Trustee of West Bengal 69CWN1010 -** The principle is, that where a power, which is purely discretionary, is given to trustees, the Court cannot exercise such power or compel the trustees to exercise such power in any particular manner, but can restrain them from exercising it in any improper manner. Further observed that where the trustees have a power as distinguished from a trust, although the Court will prevent them from executing the power unreasonably, it will not oblige them to exercise it. Impartiality among the beneficiaries is one of the basic duties and obligations of the trustee.
2. **Commissioner Of Income Tax vs Venu Suresh Sanjay Trust 1996 221 ITR 649 Mad** – It was held that the representative assessee in the case of a discretionary trust must be regarded as an individual and thus would be entitled to the benefit of deductions under Sec 80L. A discretionary trust is obviously not an HUF nor an AOP contemplated by that section. Therefore, such a trust would become entitled to the deductions provided it can be regarded as an individual.

CASE LAWS

1. **ITA Nos. 2795 to 2798/Mum/2011 Mr. Hasmukh I. Gandhi Vs. Dy. CIT –** Appellants were beneficiaries in Manichi Trust. Trust accounts were in a LGT bank. AO held that interest income accrued in the Trust bank a/cs shall be liable to tax in the hands of Appellants. ITAT held that the contention of the appellant about being unaware of being a beneficiary is not acceptable unless the appellant brings on record any evidence to establish their claims. ITAT observed that "if the statement of a sovereign Govt. is not acceptable as reliable evidence in Indian tax proceedings, no case of cross- border transaction can ever be detected or proved.“ Appellant has to give proper explanations and disclose facts which are in his exclusive knowledge.

2. **Jyotendarsinghji vs.S.I.Tripathi 1993 SCR (2) 938** has ruled that the revenue has an option in case of a discretionary Trust either to make an assessment upon Trustees or to make an assessment upon beneficiaries.

3. **Late Smt. Shantaben M. Patel L/H Sri Manubhai K. Patel in ITA No. 5000/Mum./2001 –** As per Sec 5, the basis of chargeability is the receipt or accrual in the hands of the trust in the relevant previous years cannot be said to have accrued in the hands of the beneficiary in the year of distribution.

CASE LAWS

1. **Commissioner Of Wealth Tax vs. Estate Of Late Hmm Vikramsinhji Of Gondal - 2014(6)SCALE529 -** In a discretionary trust:
   1. A beneficiary has no right to any part of the income of the trust property,
   2. Trust Property vests in the trustees a discretionary power to pay him, or apply for his benefit, such part of the income as they think fit.
   3. The trustees must exercise their discretion as and when the income becomes available, but if they fail to distribute in due time, the power is not extinguished.
   4. They have no power to bind themselves for the future.
   5. The beneficiary thus has no more than a hope that the discretion will be exercised in his favour.
   6. That the Trustees distributes to a beneficiary what the beneficiary asks him to doesn't create a vested right in thebeneficiary

2. **Commissioner of Income Tax, Gujarat, Ahmedabad Vs Kamalini Khatau AIR1994SC2759** – The SC held that the Revenue has option to assess either the trustee or the beneficiary in respect of income received by the Trust and distributed to the beneficiary in the course of the accounting year u/s 5.

3. **Dwarka Prasad Agarwal v/s ITO** – On validity of Corporate Gift - ITAT held the gift to be a valid gift.

THANK YOU!!