

CONCEPT OF TRUST

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1. CONCEPT OF TRUST

Trusts as we know them today have a long and storied history. The modern concept of trust law has its roots in English law arising from notions of feudal land ownership in the twelfth century and Henry VIII's "Statute of Uses" in the sixteenth century. In medieval England, landowners employed trusts (called "uses") like the cestuy que use to grant land to others for the use of an intended beneficiary for a limited time. In this way original ownership could be preserved by transferring land to others to avoid "feudal incidents" (fees or taxes payable to the king). Uses were also commonly employed to circumvent the rule against wills of land. This went on for centuries until, 1553, when Henry VIII tried to stamp out uses as a method of avoiding taxes payable to the British Crown, and forced through the English Parliament the "Statute of Uses" which ended the practice of creating uses in real property. While the Statute of Uses succeeded in eliminating uses, it ultimately resulted in English courts developing a body of land trust law whereby one person holds full title to a property for the benefit of another person, who may direct the management and use of the property, which forms the basis of trust law today.

The novel separation of legal and equitable title in turn gave rise to the concept of a fiduciary and the associated duties and responsibilities recognized today across the spectrum of common law, statute, and jurisprudence. As Western economies developed, the mechanics and legal principles behind land trusts became more broadly useful in the context of commercial transactions and investments.

A trust is a fiduciary relationship in which one party, known as a Settlor, gives another party, the trustee, the right to hold title to property or assets for the benefit of a third party, the beneficiary. Trusts are established to provide legal protection for the Settlor's assets, to make sure those assets are distributed according to the wishes of the Settlor, and to save time, reduce paperwork and, in some cases, avoid or reduce inheritance or estate taxes. In finance, a trust can also be a type of closed-end fund built as a public limited company.

Trusts are created by settlors (any person along with his or her lawyer) who decide how to transfer parts or all of their assets to trustees. These trustees hold on to the assets for the beneficiaries of the trust. The rules of a trust depend on the law of the land and the terms on which it was built. In some areas, it is possible for older beneficiaries to become trustees. For example, in some jurisdictions, the grantor can be a lifetime beneficiary and a trustee at the same time.

A trust can be used to determine how a person's money should be managed and distributed while that person is alive, or after their death. A trust helps avoid taxes and probate. It can protect assets from creditors, and it can dictate the terms of an inheritance for beneficiaries. The disadvantages of trusts are that they require time and money to create, and they cannot be easily revoked.

A trust is one way to provide for a beneficiary who is underage or has a mental disability that may impair his ability to manage finances. Once the beneficiary is deemed capable of managing his assets, he will receive possession of the trust.

2. ESSENTIALS OF A TRUST

In order to establish a trust, three elements are necessary:

- There must be a manifestation of intent to create a trust by the settler;
- There must be property that is to be held by the trustee (the trust “**corpus**” or trust “**res**”); and,
- There must be an identified beneficiary or purpose for which the property is held in trust.

Perhaps the most critical of these requirements is the manifestation of intent to create a trust – or, stated differently, the intent to create a relationship that encompasses the essential elements of a trust. Courts will generally not recognize the existence of a trust unless the settler’s intent to create a trust was “clear and unequivocal” or “**definite and particular**”– in other words, that the language used in the documents or conveyance that create the trust (known as the trust instrument) must indicate the settler’s intent to create the relationship to some reasonable level of certainty.

However, courts will recognize a manifestation of intent if this intent can be inferred from the language, even if the trust instrument does not expressly indicate that a trust relationship is intended. In making this determination, courts will also look to the surrounding circumstances, the parties’ conduct, the purpose of the transaction, the scheme of distribution provided by the trust instrument, and the relationship between the parties. In essence, if there is any ambiguity in the language used by the settler, the court will attempt to place itself in the position of the settler at the time of the grant to discern the settler’s purpose and intent. This has given rise to the recognition of the “**3 Certainties of a Trust**”.

3. THREE CERTAINTIES OF THE TRUST

For a trust to be valid, it requires the coincidence of three conditions which are known as "the three certainties". If any of these conditions are absent then the trust will be void ab initio, from the very start. The proposition of the three certainties is taken from the dictum of Lord Langdale in the leading case *Knight v Knight*.

For a trust to be valid there must be: certainty of intention or words; a certainty of subject-matter; and a certainty of objects.

- Certainty of Intention or words: The Settlor must have shown to have intended to create a trust before the court will hold that one has been created. No particular form of words is needed and it is not even necessary to use the word "trust". Similarly, there is no actual requirement for the trust to be in writing, but it would be a brave trustee not to have at least some evidence of his appointment.
- Certainty of subject matter: There are two aspects to this requirement:
 - a) There must be certainty as to what property is to be held upon trust; and
 - b) there must be certainty as to the extent of the beneficial interest of each beneficiary.
- Certainty of Objects: It is essential that the beneficiaries under a trust should be clearly defined or that a formula exists which enables the trustees to ascertain them. If a trustee makes a distribution to non-objects, then they may be held personally liable to replace the assets. There are different tests for certainty of objects in fixed and discretionary trusts.

4. UNCERTAINTY OF THE TRUST

Where there is not sufficient clarity, the trust may be held void as uncertain. The applicable forms of uncertainty have been categorised as:

- Conceptual uncertainty – If as a concept the Trust was not clear to the Settlor, or there was a mistake in understanding what was being done, or for what purpose, or where the words of the trust are ambiguous, then the Trust is held to have conceptual uncertainty. This will make the trust liable to be held void ab initio.
- Evidential uncertainty – the difficulty of proving whether a person falls within the class. Whether evidential certainty is required for a trust to operate depends on the type of trust in question, in particular whether the trust is fixed or discretionary.
- Administrative – where the trust is being operated in a way which gives rise to a belief that the settlor never intended to part with the trust assets, perhaps by retaining excessive control, or the conduct of the Trustees is such that the de facto control remains with the Settlor, the trust is held to be an administrative sham.

5. ROLES IN A TRUST

There are three parties central to the creation of a trust, each with a unique role to play. These three parties are outlined below:

- **The Settlor**

The Settlor is the creator of the trust. This person has built an asset base and wants to ensure that those assets are distributed according to his or her wishes or used for specified purposes. The grantor does not have to be significantly wealthy or have a large number of properties or assets. The grantor may be a parent with a large life insurance policy who wants to guarantee that his or her children are provided for without receiving a large sum of cash all at once.

The Settlor has ultimate control in setting up the trust: type of trust to be settled, term of the trust, determining which assets will be transferred into trust; who will serve as trustee while he or she is living and after his or her death; and how the trust property will be administered during or after his or her lifetime.

- **The Trustee**

The trustee is the legal owner of the Trust Funds and income. S/he/It is responsible for managing and administering the trust and strictly adhering to the terms of the trust as

well as applicable state law in performing its duties. The trustee must be legally competent to accept the trust property he or she is to manage.

The trustee is held to strict fiduciary standards. This ensures that the trustee can only use assets from the trust property for the beneficiaries, not for the trustee's benefit.

- **The Beneficiary**

This person or group of people benefits from the trust, eventually receiving some or all of the property placed in the trust. While the trustee holds the "legal title," beneficiaries have the "equitable title," meaning that the assets should be used for their benefit as stipulated in the trust document. The beneficiaries of the trust must be clearly identified or ascertainable. This could be something such as naming all current beneficiaries and then allowing for the inclusion of others born after the trust's inception.

6. TYPES OF TRUST

While there are a number of different types of trusts, the basic types are given as below:

- **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. The Constructive Trust 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 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.
- **Simple Trust:** Trustee is just passive depository of the Trust property. No active duties are 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.
- **Inter-vivos Trust:** A Settlor who is living at the time the trust is established creates an inter-vivos 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.
- **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 Trust for a minor (to X if she attains 21)
 - A life Interest (to pay the income to X for her lifetime)
- **Hybrid Trust:** Combines elements of both fixed and discretionary Trusts

7. PRIVATE TRUST

A trust is called a private trust when it is constituted for the benefit of one or more individuals who are ascertained. Private trusts are governed by the Indian Trusts Act, 1882. A private trust may be created inter vivos or by will. If a trust is created by will it shall be subject to the provisions of the Indian Succession Act, 1925. Private trusts are increasingly playing a role in the protection of wealth.

8. PUBLIC TRUST

Trusts designed for the benefit of a class or the public generally. In general, such trusts must be created for charitable, educational, religious or scientific purposes. Public trusts may be created inter vivos or by will. Generally, a public trust is of a more permanent nature than a private trust. Religious endowments and wakfs are variants of public trusts that come into being when an endowment, usually, property, is dedicated for religious purposes. The creation of religious charitable trusts is governed by the personal laws of the religion.

9. LEGISLATIONS IN RELATION TO TRUSTS IN INDIA

- 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 statutes 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 1951)
- 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)

10. 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.

11. WHY HAVE TRUST

- 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

12. 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.

13. 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.

- 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 Charitable Trusts and Trusts of Imperfect Obligation

- 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".

- 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.

- 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.

14. RELEVANT INCOME TAX PROVISIONS RELATED TO THE TRUST

- Section 5 – defines the scope of income.
- Section 11 - Tax exemption for income of Charity Trust if it complies with the rules.
- Section 12 A - Specifies registration & other conditions for a Charity trust to avail Tax exemptions.
- Section 13 - Specifies conditions under which tax exemption may not be claimed by a Charity Trust.
- Section 13B – Provisions regarding receipt of contributions by Electoral Trusts
- 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.

- 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.
- 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.
- Sections 60-63 – when a Trust may be treated as revocable.
- Section 133 A - States that the ITO can conduct surveys under section 133A on trustees and places of activity for charitable purpose.
- Section 139 A - Mandatory Requirement of obtaining PAN for the Trustees.
- Chapter 15 - Section 160-165 – Conditions under which Trustee of trust are taxed as Representative Assessee of the beneficiaries and charging of tax.
- Section 166 - Choice for AO to assess either the representative assessee or to the person whom he represents.

15. SOME RELEVANT CASE LAWS

- CIT Vs. ANDHRA CHAMBER OF COMMERCE (1965) 55 ITR 722(SC)
- CIT Vs. BAR COUNCIL OF MAHARASHTRA (1981) 130ITR 28(SC)
- Commissioner of Income Tax, Bombay City-II Vs. Walchand Diamond Jubilee Trust [1958]34ITR228(Bom)
- Cecil Libovitz Vs. Official Trustee of West Bengal 69CWN1010
- Commissioner Of Income Tax vs Venu Suresh Sanjay Trust 1996 221 ITR 649 Mad
- ITA Nos. 2795 to 2798/Mum/2011 Mr. Hasmukh I. Gandhi Vs. Dy. CIT
- Jyotendarsinghji vs.S.I.Tripathi 1993 SCR (2) 938
- Late Smt. Shantaben M. Patel L/H Sri Manubhai K. Patel in ITA No. 5000/Mum/2001
- Commissioner Of Wealth Tax vs. Estate Of Late Hmm Vikramsinhji Of Gondal -

2014(6)SCALE529

- Commissioner of Income Tax, Gujarat, Ahmedabad Vs Kamalini Khatau AIR1994SC2759
- Dwarka Prasad Agarwal v/s ITO ITA 4591 & 4592 of 2016.
- Arun Sungloo v/s CIT ITA 116/2011.
