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Private Trusts as Intermediaries in Taxation

FROM the point of view of taxation, a private trust is an intermediary between the taxpayer and the Revenue, like a company or a firm. It is like a firm, and unlike a company, in not having a juridical personality, capable of suing or being sued.¹ But, while a firm is treated as a legal entity for the limited purpose of taxation of income,² a trust is not. Just as the term "partnership" describes the relationship between the persons who have agreed to share the profits of a business conducted by them, a "private trust" is a convenient expression for describing a commitment for the benefit of one or more persons, and the financial arrangements made to that end. Each of the three genres appears to be specially adapted for particular purposes. Firms are in vogue in trading activities which are not widespread; and corporations are in demand for large-scale trading and for industrial undertakings. In the past, trusts were used mostly for long-term investments in arrangements for ensuring financial security for a settlor's family, but of late, they have also become agencies for running a business, without some of the inhibitions from which partnership concerns and companies suffer.

Trusts have played a predominant part wherever tax has been levied on transfers of properties on death or *inter vivos* gifts. They have also assumed an increasingly important role in the taxation of individual income and wealth. In an ideal operation of the law, taxes are expected to be neutral as between assets held in trust and those which are held absolutely;

and no tax advantage should be gained by anyone through recourse to an intermediary. But no country has been able to achieve this ideal. This is because the tax treatment of a trust is overlaid with practical as well as legal difficulties and it offers boundless scope for the exercise of ingenuity in securing tax reduction.

As pointed out in Chapter 1, there may be circumstances in which trusts are constituted without any intention to avoid tax. For instance, a trust is probably the safest method for ensuring that heirs who are mentally unsound or retarded, or suffering from serious physical disabilities, are properly looked after during their lifetime. It may also satisfactorily serve minor children, or a spouse who does not have adequate experience in the management of financial affairs. It may be better than an outright gift in the case of a dependant in whose judgment one has no confidence but about whose welfare one is anxious³. Experience has shown that barring such special cases, a private trust is resorted to primarily for artificial fragmentation of income and wealth. It is human nature to make all possible efforts to preserve one's fortune intact for successive generations. The paramount consideration in setting up a private trust is to provide for people in whom one is intimately interested, as long as possible, at the least cost in terms of tax liability.

A trust does not come into existence spontaneously, by the adoption of a standard form of instrument. It is designed to suit the requirements of the individual cases and, in the process, provides ample opportunity for tax manoeuvres. For this reason, it is sustained less by statute than by case law. Since a family settlement affects comparatively few people, it enjoys a sheltered privacy without any legal compulsion, as in the case of a company, to file or register any document with any prescribed authority⁴.

NOTES

1. ". . . although, for purposes of the Income-tax Act, a firm has certain attributes simulative of personality, we have to take it that a partnership is *not a person* but a plurality of persons." CIT v C.M. Chidambaram Pillai (1977) 106 ITR 292 at p. 300 (SC).

2. A "person" has been defined in Section 2 (31) of the Income-tax Act to include (i) an individual, (ii) a Hindu undivided family, (iii) a company, (iv) a firm, (v) an association of persons or a body of individuals, whether incorporated or not, (vi) a local authority and (vii) every artificial juridical person, not falling within any of the preceding categories. Sub-section (7) of section 2 states that an "assessee" means "a person by whom any tax or any other sum of money is payable under this Act". Section 4 provides for levy of tax "in respect of the total income of the previous year or previous years, as the case may be, of every person." Section 6 (2) lays down that "a Hindu undivided family, firm or other association of persons is said to be resident in India in any previous year except where during that year the control and management of its affairs is situated wholly outside India."
3. Income from property settled on trust was not includible in the total income of the settlor under the Indian Income-tax Act, 1922, even if the settlor appointed himself as the trustee with full powers to lease out, mortgage or encumber the properties and he was not accountable to the other trustees for his dealings : CIT v Brojendranath Kundu (1977) 110 ITR 336 (Cal) ; CIT v Jayantilal Amritlal (1968) 67 ITR 1 (SC).
4. All charitable and religious trusts and institutions seeking tax exemption under sections 11 and 12 of the Income-tax Act should register themselves with the concerned Commissioners of Income-tax under section 12A of the Act. Private trusts are not required to do so. Similarly, some of the States have legislation for registering religious and charitable trusts or only Hindu religious trusts and also for supervision of their working : The Bombay Public Trusts Act 1950 (applied to Gujarat also), the Rajasthan Public Trusts Act 1959, the Madhya Pradesh Public Trusts Act 1951, the Madras Hindu Religious and Charitable Endowments Act 1959, the Bihar Hindu Religious Trusts Act 1950, the Orissa Hindu Religious Endowments Act 1969, and the Travancore-Cochin Hindu Religious Institutions Act, 1950. The Waqf Act 1954 provides for the registration and survey of public *waqfs* in the entire country (except Jammu & Kashmir). The Indian Trusts Act, which covers different aspects of the creation and operation of private trusts, does not, however, have any similar provision.