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Concluding Observations

THE trust was conjured up by equity to supplement the common law in the UK. It was based on the principle of natural justice that the reality of a situation should be recognised in law and that those for whom the hidebound courts provided no remedy could turn to the Lord Chancellor for succour. It is an irony that the trust has evolved as a device to outwit the Chancellor of the Exchequer in the UK. The height of irony is that it has come to be treated in India as a *purdah* which cannot be lifted for getting at the truth : once a settlement is made the Revenue cannot, according to a judicial pronouncement, go behind its motives.[1] The suggestion in Chapter 8 is that since a family trust functions almost like a close company, there should be near-parity in their tax treatment.

The question that requires consideration in this context is whether such a treatment will have an adverse effect on the economy : the issue is not merely the use of a trust as a contrivance for dodging tax but its role in the economy. There are no data to show that private trusts have made any significant contribution to the growth of trade and industry in this country. Well-heeled private trusts with a lot of money may be a measure of a person's wealth but they have a negative effect on saving and risk taking. An outright gift puts a person on his mettle while a trust lulls his initiative and makes him dependent on the estate.[2] Investments held in trust lack mobility; and trustees are generally conservative and non-innovative[3]. Either the settlor does not want the investments in the companies of his group to be changed or the trustees do not consider

it safe. If the aim of a trust is a certain, steady and secure return on the capital provided by the settlor, a trustee will not dare to expose the capital to the hazards of a business. His legal competence to undertake a business is also open to doubt, unless he is given the necessary authority in the trust deed. A trustee in a pubic trust may have accepted the ·trusteeship out of a sense of civic responsibility or hankering for the prestige and privilege that go with it, but the trustee of a private trust can only be a relative or a family friend or an employee or a person appointed by a court or the Official Trustee, the Court-of-wards or the Administrator-General or a bank or a company rendering trusteeship services. To expect any shrewd investment from a trustee is unrealistic because of his accountability in law for any decision he takes[4]. He usually plays safe even if he has the power to convert the assets or venture into business. The beneficiaries are prone to look on him with dislike and suspicion if the trust is genuine and as a fellow-conspirator if it is sham.

If the beneficiaries of a trust are dependent on the settlor's bounty, it is improbable that the income that they derive from the trust will be saved. It may just meet their consumption requirements. If it is a mere apparatus for tax reduction, it is likely that the tax saved will be utilised in further investment; but the State cannot be a party to a taxpayer's consolidating his personal wealth out of its funds or at its expense.

Implications of near-parity with a close company

The Court decisions bearing on private trusts during the last thirty years, which are over 150 in number, and the annual reports of the Comptroller and Auditor General to the Parliament, make it clear that the investments in private trusts and also the income from them are not negligible. The Revenue should not obviously tinker with the law, making periphrastic changes, every time a court delivers an adverse judgment or a new tax fiddle comes to light. However, since every loophole and every adverse judgment would, in effect, be an indictment of the administration and the legislature, it is essential that the law should be rationalized and properly drafted : anticipation of abuses is as essential as reform. Irrespective of whether the tax avoided is inconsequential or considerable, the adminis-

tration should not be allowed to get stalled over issues which might not have been raised at all if the law had been clearer and more comprehensive. It is also essential that the law should be so framed that those who are in a position to hire the best legal advice do not succeed in shifting their share of the tax burden to the less fortunate. The income tax and the wealth tax should not be reduced to taxes on lack of ingenuity or lack of desire to avoid them.

A private trust has a limited social purpose in the present-day conditions. No benefit to the community can be urged as a justification for it, with reference to the pecuniary advantages enjoyed by the relatively few taxpayers in the high income brackets. The neutrality of the direct taxes in family arrangements may ensure that extraneous tax avoidance considerations do not influence the taxpayer's choice of a medium for his investment or business or professional activities; and this neutrality can be achieved through the legislative measures spelt out in Chapter 8, which can be summarised as follows :

(a) Trusts may be declared taxable entities like Hindu undivided families and firms;

(b) all private trusts may be required to be registered with the tax authorities and assessed to the income tax at the maximum marginal rate applicable to individuals, i.e., at rates slightly lower than those charged in respect of close companies, with imputation to the beneficiaries of the tax paid by them in proportion to the benefits actually enjoyed, where the trusts are specific and are not also engaged in business or professional activity; alternatively, if the beneficiaries are not proposed to be given such a tax credit, their proportionate income in a trust may be aggregated with the rest of their income only for determining the tax rate applicable to the other income;

(c) the wealth tax may be charged at 3 per cent or the appropriate marginal rate where it is beneficial to the revenue[5]: a trust may be granted tax exemption only where it is established that none of its beneficiaries will have taxable wealth in the relevant assessment year;

(d) the existing lacunae in all the direct taxes laws may be removed and a provision also made enabling the administration to supersede tax avoidance arrangements, subject to the taxpayer's right of appeal; and

(e) genuine trusts for specified classes of beneficiaries—e.g., the mentally unsound, the physically disabled, those deprived of parental care in infancy, widows without help and those rendered infirm and dependent in old age—may be taxed at the marginal rates appropriate to their beneficiaries' income and wealth, or even lower, concessional rates.

Legislation on the above lines may be the end of the road for phoney trusts[6]. Discouragement of family trusts created primarily for tax avoidance is unlikely to leave an economic, social or moral vacuum.

NOTES

1. K.T. Doctor, v. CIT (1980) 124 ITR 501 (Guj).
2. Though the Musalman Waqf Validating Act, 1930, superseded the Privy Council Judgment in Abu Fata Mohamed Ishak v Russomoy Dhur Chowdhury (1894) 22 IA 76, there is a section of opinion among Muslims in India that its social consequences have been disastrous for Muslims and that indefinite settlements tend not merely to fragment estates but also create a demoralised class of pensioners, vide Daniel Latife, General Secretary of the Muslim Progressive Group, "Law of Family Waqfs : Need for a reconsideration", *Islamic Law of Modern India*, New Delhi, The Indian Law Institute, 1972, pp 228-30. Also S. Khalid Rashid, "Administration of Waqfs in India", *ibid.*, pp. 237-38.
3. The Canadian experience is similar; Robin W. Boadway and Harry M. Kitchen (1979), *Canadian Tax Policy*, Canadian Tax Foundation, p. 80 : "While data of the use of trust are not available in Quebec, they are primarily used by the wealthy and as such allow these individuals to exempt large amount of their wealth from taxation. Further criticism centres on the suggestions that substantial sums of property become tied up in trusts with a consequent lack of flexibility in investment activity. In addition, trust investments are generally concentrated in more conservative, less risk ventures."
4. Learoyd v Whitely (1887) 12 App. Cas. 727, 733; Re. Cooper's Settlement (1961)3 All ER 636; Re. Kolb's Will Trusts (1961) 3 All ER

811; Re. Clark's Will Trusts (1961)3 All ER 1133; Shaw v Cates (1909) 1 Ch. 389; Re. Solomon (1912) 1 Ch. 261; Re. Walker v Walker 62 IT 449; Re. Harari's Settlement Trusts (1949) 1 All ER 430.

5. See Harry Rudick (1950), "What Alternative to the Estate and Gift Taxes", *Californian Law Review*, Vol. 38, pp. 169-75. It was suggested by Rudwick that there should be an annual accession tax on trusts, based on the benefits derived by the income beneficiary, and the remaindermen's tax liability determined on the termination of the trusts with reference to the value of the corpus. The tax on the life tenant would compensate the delay in the settlement of the liability on the capital. The aim would be to make assets transferred on trust pay about the same amount of tax as assets transferred outright. The purpose can, perhaps, be achieved also by harmonising the income tax, wealth tax, gift tax and estate duty levies. Such refinement in harmonisation may, however, be an exercise in futility as long as trustsare used as mere tax avoidance devices.
6. The English experience in regard to discretionary and accumulation trusts has been succinctly expressed in Prof. G. S. A. Wheatcroft's observation quoted at p. 83 ante; and the reaction of the Revenue is reflected in the recent amendments to the Capital Transfer Tax provisions in that country. See also C.T. Sandford, 1977, *Taxing Personal Wealth*, London, George Allen and Unwin.