FOR CLIENTS ONLY

TRUSTS
AND
TAXES

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Trusts and Taxes

Overview

A trust is a way of managing assets (money, investments, land or buildings) for people. There are different types of trusts and they are taxed differently.

Trusts involve:

- the 'settlor' - the person who puts assets into a trust
- the 'trustee' - the person who manages the trust
- the 'beneficiary' - the person who benefits from the trust

What trusts are for

Trusts are set up for a number of reasons, including:

- to control and protect family assets
- when someone's too young to handle their affairs
- when someone cannot handle their affairs because they're incapacitated
- to pass on assets while you're still alive
- to pass on assets when you die (a 'will trust')
- under the rules of inheritance if someone dies without a will (in England and Wales)

What the settlor does

The settlor decides how the assets in a trust should be used - this is usually set out in a document called the 'trust deed'.

Sometimes the settlor can also benefit from the assets in a trust - this is called a 'settlor-interested' trust and has special tax rules. Find out more by reading the information on different types of trust.

What trustees do

The trustees are the legal owners of the assets held in a trust. Their role is to:

- deal with the assets according to the settlor's wishes, as set out in the trust deed or their will
- manage the trust on a day-to-day basis and pay any tax due
- decide how to invest or use the trust's assets

If the trustees change, the trust can still continue, but there always has to be at least one trustee.

Beneficiaries

There might be more than one beneficiary, like a whole family or defined group of people. They may benefit from:

- the income of a trust only, for example from renting out a house held in a trust
- the capital only, for example getting shares held in a trust when they reach a certain age
- both the income and capital of the trust

Types of trust

The main types of trust are:

- bare trusts
- interest in possession trusts
- discretionary trusts
- accumulation trusts
- mixed trusts
- settlor-interested trusts
- non-resident trusts

Each type of trust is taxed differently. Trusts involve a 'trustee', 'settlor' and 'beneficiary'.

Bare trusts

Assets in a bare trust are held in the name of a trustee. However, the beneficiary has the right to all of the capital and income of the trust at any time if they're 18 or over (in England and Wales), or 16 or over (in Scotland). This means the assets set aside by the settlor will always go directly to the intended beneficiary.

Bare trusts are often used to pass assets to young people - the trustees look after them until the beneficiary is old enough.

Example:

You leave your sister some money in your will. The money is held in trust.

Your sister is entitled to the money and any income (for example interest) it earns. She can also take possession of any of the money at any time.

Interest in possession trusts

These are trusts where the trustee must pass on all trust income to the beneficiary as it arises (less any expenses).

Example:

You create a trust for all the shares you owned.

The terms of the trust say that when you die, the income from those shares go to your wife for the rest of her life. When she dies, the shares will pass to your children.

Your wife is the income beneficiary and has an 'interest in possession' in the trust. She does not have a right to the shares themselves.

Discretionary trusts

These are where the trustees can make certain decisions about how to use the trust income, and sometimes the capital.

Depending on the trust deed, trustees can decide:

- what gets paid out (income or capital)
- which beneficiary to make payments to
- how often payments are made
- any conditions to impose on the beneficiaries

Discretionary trusts are sometimes set up to put assets aside for:

- a future need, like a grandchild who may need more financial help than other beneficiaries at some point in their life
- beneficiaries who are not capable or responsible enough to deal with money themselves

Accumulation trusts

This is where the trustees can accumulate income within the trust and add it to the trust's capital. They may also be able to pay income out, as with discretionary trusts.

Mixed trusts

These are a combination of more than one type of trust. The different parts of the trust are treated according to the tax rules that apply to each part.

Settlor-interested trusts

These are where the settlor or their spouse or civil partner benefits from the trust. The trust could be:

- an interest in possession trust
- an accumulation trust
- a discretionary trust

Example:

You can no longer work due to illness. You set up a discretionary trust to make sure you have money in the future.

You're the settlor - you may also benefit from the trust because the trustees can make payments to you.

Non-resident trusts

This is a trust where the trustees are not resident in the UK for tax purposes. The tax rules for non-resident trusts are very complicated.

Parental trusts for children

These are trusts set up by parents for children under 18 who have never been married or in a civil partnership. They're not a type of trust in their own right but will be either:

- a bare trust
- an interest in possession trust
- an accumulation trust
- a discretionary trust

Read the information on types of trust to find out more.

Income Tax

Income Tax on income from the trust is paid by the trustees, but the 'settlor' is responsible for it. This means:

1. The trustees pay Income Tax on the trust income by filling out a Trust and Estate Tax Return.
2. They give the settlor a statement of all the income and the rates of tax charged on it.
3. The settlor tells HM Revenue and Customs (HMRC) about the tax the trustees have paid on their behalf when filling out their Self Assessment tax return.

Trusts for vulnerable people

Some trusts for disabled people or children get special tax treatment. These are called 'trusts for vulnerable beneficiaries'.

Who qualifies as a vulnerable beneficiary

A vulnerable beneficiary is either someone under 18 whose parent has died or a disabled person who is eligible for any of the following benefits (even if they do not receive them):

- Attendance Allowance
- Disability Living Allowance (either the care component at the highest or middle rate, or the mobility component at the higher rate)
- Personal Independence Payment
- an increased disablement pension
- Constant Attendance Allowance
- Armed Forces Independence Payment
- Child Disability Payment

A vulnerable beneficiary can also be someone who is unable to manage their own affairs because of a mental health condition - check with a medical professional that it's covered by the Mental Health Act 1983.

Trusts that qualify for special tax treatment

A trust does not qualify for special Income Tax treatment if the person setting it up can benefit from the trust income. However, from 2008 to 2009 it would qualify for special Capital Gains Tax treatment.

Trusts for children who've lost a parent are usually set up by the parent's will, or by special rules of inheritance if there's no will.

If someone dies without a will in Scotland, a trust set up there for their children is usually treated as a bare trust for tax purposes.

If there's more than one beneficiary

If there are beneficiaries who are not vulnerable, the assets and income for the vulnerable beneficiary must be:

- identified and kept separate
- used only for that person

Only that part of the trust gets special tax treatment.

Claiming special tax treatment

To claim special treatment for Income Tax and Capital Gains Tax, the trustees have to fill in the ‘Vulnerable Person Election’ form.

If there’s more than one vulnerable beneficiary, each needs a separate form.

The trustees and beneficiary must both sign the form.

If the vulnerable person dies or is no longer vulnerable, the trustees must tell HMRC.

Income Tax

In a trust with a vulnerable beneficiary, the trustees are entitled to a deduction of Income Tax. It’s calculated like this:

1. Trustees work out what their trust Income Tax would be if there was no claim for special treatment - this will vary according to which type of trust it is.
2. They then work out what Income Tax the vulnerable person would have paid if the trust income had been paid directly to them as an individual.
3. They can then claim the difference between these 2 figures as a deduction from their own Income Tax liability.

This is a complicated calculation but there’s a detailed worked example on the HMRC website.

Capital Gains Tax

Capital Gains Tax may be due if assets are sold, given away, exchanged or transferred in another way and they’ve gone up in value since being put into trust.

Tax is only paid by trustees if the assets have increased in value above the ‘annual exempt amount’, which is an allowance of £12,300 for people who have a mental or physical disability, or £6,150 for other trustees.

Trustees are responsible for paying any Capital Gains Tax due. If the trust is for vulnerable people, trustees can claim a reduction, which is calculated like this:

1. They work out what they would pay if there was no reduction.
2. They then work out what the beneficiary would have to pay if the gains had come directly to them.
3. They can claim the difference between these 2 amounts as a reduction on what they have to pay in Capital Gains Tax using form SA905.

This special Capital Gains Tax treatment does not apply in the tax year when the beneficiary dies.

Inheritance Tax

These are the situations when trusts for vulnerable people get special Inheritance Tax treatment:

- for a disabled person whose trust was set up before 8 April 2013 - at least half of the payments from the trust must go to the disabled person during their lifetime
- for a disabled person whose trust was set up on or after 8 April 2013 - all payments must go to the disabled person, except for up to £3,000 per year (or 3% of the assets, if that's lower), which can be used for someone else's benefit
- when someone who has a condition that's expected to make them disabled sets up a trust for themselves
- for a bereaved minor - they must take all the assets and income at (or before becoming) 18

There's no Inheritance Tax charge:

- if the person who set up the trust survives 7 years from the date they set it up
- on transfers made out of a trust to a vulnerable beneficiary

When the beneficiary dies, any assets held in the trust on their behalf are treated as part of their estate and Inheritance Tax may be charged.

Trusts usually have 10-year Inheritance Tax charges, but trusts with vulnerable beneficiaries are exempt.

Trusts and Income Tax

Different types of trust income have different rates of Income Tax.

Each type of trust is taxed differently. Trusts involve a ‘trustee’, ‘settlor’ and ‘beneficiary’.

Accumulation or discretionary trusts

Trustees are responsible for paying tax on income received by accumulation or discretionary trusts. The first £1,000 is taxed at the standard rate.

If the settlor has more than one trust, this £1,000 is divided by the number of trusts they have. However, if the settlor has set up 5 or more trusts, the standard rate band for each trust is £200.

The tax rates are below.

Trust income up to £1,000

Type of income	Tax rate
Dividend-type income	7.5%
All other income	20%

Trust income over £1,000

Type of income	Tax rate
Dividend-type income	38.1%
All other income	45%

Dividends

Trustees do not qualify for the dividend allowance. This means trustees pay tax on all dividends depending on the tax band they fall within.

Interest in possession trusts

The trustees are responsible for paying Income Tax at the rates below.

Type of income	Income Tax rate
Dividend-type income	7.5%

Type of income	Income Tax rate
All other income	20%

Sometimes the trustees ‘mandate’ income to the beneficiary. This means it goes to them directly instead of being passed through the trustees.

If this happens, the beneficiary needs to include this on their Self Assessment tax return and pay tax on it.

Bare trusts

If you’re the beneficiary of a bare trust you’re responsible for paying tax on income from it.

You need to tell HMRC about the income on a Self Assessment tax return.

If you do not usually send a tax return, you need to register for self-assessment by 5 October following the tax year you had the income.

Settlor-interested trusts

The settlor is responsible for Income Tax on these trusts, even if some of the income is not paid out to them. However, the Income Tax is paid by the trustees as they receive the income.

1. The trustees pay Income Tax on the trust income by filling out a Trust and Estate Tax Return.
2. They give the settlor a statement of all the income and the rates of tax charged on it.
3. The settlor tells HMRC about the tax the trustees have paid on their behalf on a Self Assessment tax return.

The rate of Income Tax depends on what type of trust the settlor-interested trust is.

Other types of trust

There are special tax rules for parental trusts for children, trusts for vulnerable people and trusts where the trustees are not resident in the UK for tax purposes. These are called non-resident trusts.

Trusts and Capital Gains Tax

Capital Gains Tax is a tax on the profit ('gain') when something (an 'asset') that's increased in value is taken out of or put into a trust.

When Capital Gains Tax might be payable

If assets are put into a trust

Tax is paid by either the person:

- selling the asset to the trust
- transferring the asset (the 'settlor')

If assets are taken out of a trust

The trustees usually have to pay the tax if they sell or transfer assets on behalf of the beneficiary.

There's no tax to pay in bare trusts if the assets are transferred to the beneficiary.

Sometimes an asset might be transferred to someone else but Capital Gains Tax is not payable. This happens when someone dies and an 'interest in possession' ends.

A beneficiary gets some or all of the assets in a trust

Sometimes the beneficiary of a trust becomes 'absolutely entitled' and can tell the trustees what to do with the assets, for example when they reach a certain age.

In this case, the trustees pay Capital Gains Tax based on the assets' market value when the beneficiary became entitled to them.

Non-UK resident trusts

The rules for Capital Gains Tax on non-UK resident trusts are complicated. You can get help with your tax.

Working out total gains

Trustees need to work out the total taxable gain to know if they have to pay Capital Gains Tax.

Allowable costs

Trustees can deduct costs to reduce gains, including:

- the cost of the property (including any administration fees)
- professional fees, for example for a solicitor or stockbroker
- the cost of improving property or land to increase its value, for example building a conservatory (but not repairs or regular maintenance)

Tax reliefs

Trustees might be able to reduce or delay the amount of tax the trust pays if gains are eligible for tax relief.

Relief	Description
Private Residence Relief	Trustees pay no Capital Gains Tax when they sell a property the trust owns. It must be the main residence for someone allowed to live there under the rules of the trust.
Business Asset Disposal Relief	Trustees pay 10% Capital Gains Tax on qualifying gains if they sell assets used in a beneficiary's business, which has now ended. They may also get relief when they sell shares in a company where the beneficiary had at least 5% of shares and voting rights.
Hold-Over Relief	Trustees pay no tax if they transfer assets to beneficiaries (or other trustees in some cases). The recipient pays tax when they sell or dispose of the assets, unless they also claim relief.

Tax-free allowance

Trustees only have to pay Capital Gains Tax if the total taxable gain is above the trust's tax-free allowance (called the Annual Exempt Amount).

The tax-free allowance for trusts is:

- £6,150
- £12,300 if the beneficiary is vulnerable - a disabled person or a child whose parent has died

If there’s more than one beneficiary, the higher allowance may apply even if only one of them is vulnerable.

See tax-free allowances for previous years.

The tax-free allowance may be reduced if the trust’s settlor has set up more than one trust (‘settlement’) since 6 June 1978.

There’s more detailed information about Capital Gains Tax and Self Assessment for trusts.

Report gains to HMRC

Trustees must report and pay any tax due on UK residential property using a Capital Gains Tax on UK property account. They must do this within:

- 60 days of selling the property if the completion date was on or after 27 October 2021
- 30 days of selling the property if the completion date was between 6 April 2020 and 26 October 2021

Trustees must report the sale or transfer of other assets in a trust and estate Self Assessment tax return.

Trusts and Inheritance Tax

Inheritance Tax may have to be paid on a person’s estate (their money and possessions) when they die.

Inheritance Tax is due at 40% on anything above the threshold - but there’s a reduced rate of 36% if the person’s will leaves more than 10% of their estate to charity.

Inheritance Tax can also apply when you’re alive if you transfer some of your estate into a trust.

When Inheritance Tax is due

The main situations when Inheritance Tax is due are:

- when assets are transferred into a trust
- when a trust reaches a 10-year anniversary of when it was set up (there are 10-yearly Inheritance Tax charges)
- when assets are transferred out of a trust (known as 'exit charges') or the trust ends
- when someone dies and a trust is involved when sorting out their estate

What you pay Inheritance Tax on

You pay Inheritance Tax on 'relevant property' - assets like money, shares, houses or land. This includes the assets in most trusts.

There are some occasions where you may not have to pay Inheritance Tax - for example where the trust contains excluded property.

Special rules

Some types of trust are treated differently for Inheritance Tax purposes.

Bare trusts

These are where the assets in a trust are held in the name of a trustee but go directly to the beneficiary, who has a right to both the assets and income of the trust.

Transfers into a bare trust may also be exempt from Inheritance Tax, as long as the person making the transfer survives for 7 years after making the transfer.

Interest in possession trusts

These are trusts where the beneficiary is entitled to trust income as it's produced - this is called their 'interest in possession'.

On assets transferred into this type of trust before 22 March 2006, there's no Inheritance Tax to pay.

On assets transferred on or after 22 March 2006, the 10-yearly Inheritance Tax charge may be due.

During the life of the trust there's no Inheritance Tax to pay as long as the asset stays in the trust and remains the 'interest' of the beneficiary.

Between 22 March 2006 and 5 October 2008:

- beneficiaries of an interest in possession trust could pass on their interest in possession to other beneficiaries, like their children
- this was called making a 'transitional serial interest'
- there's no Inheritance Tax to pay in this situation

From 5 October 2008:

- beneficiaries of an interest in possession trust cannot pass their interest on as a transitional serial interest
- if an interest is transferred after this date there may be a charge of 20% and a 10-yearly Inheritance Tax charge will be payable unless it's a disabled trust

If you inherit an interest in possession trust from someone who has died, there's no Inheritance Tax at the 10-year anniversary. Instead, 40% tax will be due when you die.

If the trust is set up by a will

Someone might ask that some or all of their assets are put into a trust. This is called a 'will trust'.

The personal representative of the deceased person has to make sure that the trust is properly set up with all taxes paid, and the trustees make sure that Inheritance Tax is paid on any future charges.

If the deceased transferred assets into a trust before they died

If you're valuing the estate of someone who has died, you'll need to find out whether they made any transfers in the 7 years before they died. If they did, and they paid 20% Inheritance Tax, you'll need to pay an extra 20% from the estate.

Even if no Inheritance Tax was due on the transfer, you still have to add its value to the person's estate when you're valuing it for Inheritance Tax purposes.

Trusts for bereaved minors

A bereaved minor is a person under 18 who has lost at least one parent or step-parent. Where a trust is set up for a bereaved minor, there are no Inheritance Tax charges if:

- the assets in the trust are set aside just for bereaved minor
- they become fully entitled to the assets by the age of 18

A trust for a bereaved young person can also be set up as an 18 to 25 trust - the 10-yearly charges do not apply. However, the main differences are:

- the beneficiary must become fully entitled to the assets in the trust by the age of 25
- when the beneficiary is aged between 18 and 25, Inheritance Tax exit charges may apply

Trusts for disabled beneficiaries

There's no 10-yearly charge or exit charge on this type of trust as long as the asset stays in the trust and remains the 'interest' of the beneficiary.

You also do not have to pay Inheritance Tax on the transfer of assets into a trust for a disabled person as long as the person making the transfer survives for 7 years after making the transfer.

Paying Inheritance Tax

You pay Inheritance Tax using form IHT100.

If you're valuing the estate of someone who's died, you may have to value other assets apart from trusts to see if Inheritance Tax is due.

Beneficiaries - paying and reclaiming tax on trusts

If you’re a trust beneficiary there are different rules depending on the type of trust. You might have to pay tax through Self Assessment or you might be entitled to a tax refund.

If you do not usually send a tax return and need to, you must register for Self Assessment by 5 October following the tax year you had the income.

Read the information on the different types of trust to understand the main differences between them. If you’re not sure what type of trust you have, ask the trustees.

If you’re the beneficiary of a bare trust you are responsible for declaring and paying tax on its income. Do this on a Self Assessment tax return.

If you do not usually send a tax return and need to, you must register for Self Assessment by 5 October following the tax year you had the income.

Interest in possession trusts

If you’re the beneficiary of this type of trust, you’re entitled to its income (after expenses) as it arises.

If you ask for a statement, the trustees must tell you:

- the different sources of income
- how much income you’ve been given
- how much tax has been paid on the income

You’ll usually get income sent through the trustees, but they might pass it to you directly without paying tax first. If this happens you need to include it on your Self Assessment tax return.

If you do not usually send a tax return you must register for Self Assessment by 5 October the year after you were given the income.

ExampleYou were given income from the trust in August 2020. You need to register for Self Assessment before 5 October 2021.

If you're a basic rate taxpayer

You will not owe any extra tax. You'll still need to complete a Self Assessment tax return to show the income you receive from an interest in possession trust but you will get a credit for the tax paid by the trustees. This means the income is not taxed twice.

If you're a higher rate taxpayer

You'll have to pay extra tax on the difference between what tax the trustees have paid and what you, as a higher rate taxpayer, are liable for. This will be calculated when you do your Self Assessment.

How to reclaim tax

You can reclaim tax paid on:

- dividends (if you're entitled to dividend allowance)
- savings interest (if you're entitled to personal savings allowance)
- trade and property income (if you're entitled to trading allowance or property allowance)

The allowance amount will be reduced if it's already been used against some income. The allowance you have left is called the 'available allowance'.

If the amount of income you receive is less than or equal to the available allowance, you can reclaim all of the tax paid.

If the amount of income you receive is more than the available allowance, you can only claim the tax paid on the available allowance.

ExampleYou received £10,000 of dividend income from a trust in the 2020 to 2021 tax year. The dividend allowance for that year was £2,000.

You have used your personal allowance but you have no other dividend income so your available dividend allowance is £2,000. The trustees have paid tax of £750 on the dividends (£10,000 x 7.5%).

You can reclaim the tax paid by the trustees on an amount equal to your available dividend allowance so you can reclaim £150 (£2000 x 7.5%).

If you're a Self Assessment taxpayer the repayment will be calculated as part of your return.

If you're not a Self Assessment taxpayer you can reclaim the tax using form R40.

You need to make a separate claim for each tax year.

Accumulation or discretionary trusts

With these trusts all income received by beneficiaries is treated as though it has already been taxed at 45%. If you're an additional rate taxpayer there will be no more tax to pay.

You may be able to claim tax back on trust income you've received if any of the following apply:

- you're a non-taxpayer
- you pay tax at the basic rate of 20%
- you pay tax at the higher rate of 40%

You can reclaim the tax paid using form R40. If you complete a tax return, you can claim through Self Assessment.

Settlor-interested discretionary trusts

If a settlor-interested trust is a discretionary trust, payments made to the settlor's spouse or civil partner are treated as though they've already been taxed at 45%. There's no more tax to pay. However, unlike payments made from other types of trusts, the tax credit cannot be claimed back.

Non-resident trusts

This is a trust where the trustees are not resident in the UK for tax purposes. The tax rules for this type of trust are very complicated - there's detailed guidance on non-resident trusts.

If a pension scheme pays into a trust

When a pension scheme pays a taxable lump sum into a trust after the pension holder dies, the payment is taxed at 45%.

If you're a beneficiary and receive a payment funded by this lump sum, you'll also be taxed.

You can claim back tax paid on the original lump sum - do this on your Self Assessment tax return if you complete one, or using form R40.

The trust will tell you the amount you need to report - this will normally be more than the amount you actually receive.

Trustees - tax responsibilities

As the trustee, you're responsible for reporting and paying tax on behalf of the trust.

If there are 2 or more trustees, nominate one as the 'principal acting trustee' to manage its tax. The other trustees are still accountable, and can be charged tax and interest if the trust does not pay.

Registering a trust

Once a trust becomes liable for tax, you must register the trust with HM Revenue and Customs.

Sending tax returns

You must report the trust's income and gains in a trust and estate Self Assessment tax return after the end of each tax year. You can either:

- buy software to send it electronically by 31 January
- fill in paper form SA900 and post it to HMRC by 31 October (3 months earlier)

You can also get help, for example from HMRC or by getting an accountant to do your return for you.

After you've sent your return, HMRC will tell you how much you owe. You'll need to pay your Self Assessment bill by the deadline.

You'll need to collect and keep records (for example bank statements) to complete your tax return.

Telling beneficiaries about tax and income

You must give the beneficiary a statement with the amount of income and tax paid by the trust, if they ask. You can use form R185 (trust) to do this. There's a different form if you need to provide a statement to a settlor who retains an interest.

If there's more than one beneficiary, you must give each of them this information relative to the amount they receive.

Death benefit payments from a pension scheme

You must give the beneficiary extra information if both the following apply:

- you make a payment funded by a taxable lump sum from a pension scheme
- the pension holder has died

Use form R185 (LSDB) if you're a trustee. There's a different form if you're a pension administrator.

You must tell the beneficiary within 30 days.

Other responsibilities

You may have to report other things to HMRC. You need to:

- use the online service to tell HMRC if there are any changes to the trust
- fill in form IHT100 when the trust needs to pay Inheritance Tax

Your other responsibilities as a trustee depend on the type of trust and any instructions from the person who set up the trust in the trust deed.

When you must register a trust

You must register your trust with HM Revenue and Customs (HMRC) if it becomes liable for any of the following:

- Capital Gains Tax
- Income Tax
- Inheritance Tax
- Stamp Duty Land Tax or Land and Buildings Transaction Tax in Scotland
- Stamp Duty Reserve Tax

You must also register a trust to claim tax relief.

Non-resident trusts

You must register a non-resident trust if it becomes liable for:

- tax on UK income
- tax on UK assets

You can get professional advice from a solicitor or tax advisor about registering a trust.

When you do not need to register your trust

You do not need to register your trust if:

- it has to pay Income Tax of less than £100 on interest
- only the settlor or beneficiary of the trust has to pay tax
- it's a bare trust
- it's a charitable trust
- it's a resulting trust and the assets go back to the settlor because all the beneficiaries have died
- it's a statutory trust created through legislation
- it's a constructive trust imposed by a court
- it holds a pension scheme already registered with HMRC

You also do not need to register your trust if you have to file information:

- under the Foreign Account Tax Compliance Act (FATCA)
- for Common Reporting Standard (CRS) purposes

Deadlines for registering

The deadline depends on the tax your trust is liable for.

Trusts liable for Income Tax or Capital Gains Tax

If it's the first time your trust is liable for either tax, the deadline is 5 October in the tax year after it first becomes liable for these taxes.

For example, if your trust first becomes liable for Income Tax during the 2020 to 2021 tax year, you must register by 5 October 2021.

If your trust has been liable for either tax before, the deadline is 31 January in the tax year after it's again liable for these taxes.

For example, if your trust is liable for Income Tax during the 2020 to 2021 tax year and it has been liable for Income Tax before, you must register by 31 January 2022.

Trusts liable for other taxes

You must register by 31 January in the tax year after the one in which the trust is liable for any of the following:

- Inheritance Tax
- Stamp Duty Land Tax or Land and Buildings Transaction Tax in Scotland
- Stamp Duty Reserve Tax

You must register by the earlier deadline if your trust is liable for more than one tax and both deadlines apply.

How to register

How you register a trust depends on whether you're:

- a trustee
- an agent registering a trust for a client

There's a different process if you need to register an estate of someone who's died.

How Are Trusts Taxed?

FAQs

With the tax season fast approaching, you may have questions about how your trust is taxed, who is responsible for tax filings, or how trust income taxes get paid. This blog will answer some common questions you may have about the taxation of your trust.

Do all trusts pay income taxes?

It depends. A trust is a separate legal and taxable entity. Whether the trust pays its own taxes depends on whether the trust is a simple trust, a complex trust, or a grantor trust. Simple trusts and complex trusts pay their own income taxes. Grantor trusts do NOT pay their own taxes – the grantor of the trust pays the taxes on a grantor trust's income.

How do I know if a trust is a simple trust?

A *simple trust* is a trust that a) requires all trust income to be distributed at least annually, b) has no charitable beneficiaries, and c) makes no distributions of trust principal.
If the trust does not meet the above definition of simple trust, it is usually either a complex trust or a grantor trust.

What is a grantor trust?

A *grantor trust* is a trust where the grantor is treated as the owner for income tax purposes only, by retaining certain powers over the trust assets as described in the trust agreement. Grantor trusts can either be revocable or irrevocable. Because of these grantor-retained powers, the grantor trust is ignored for income tax purposes. Some of these powers include:

- Grantor or the grantor's spouse retains the power to revoke or amend the trust (i.e., **revocable trusts**), OR
- Grantor retains the power to substitute trust assets with assets of equal value, OR
- Grantor retains power to borrow trust assets without adequate security, OR
- Grantor or grantor's spouse may receive distributions from the trust (i.e., **spousal lifetime access trusts**), OR

- Trust income may be used to pay premiums on life insurance policies on life of grantor or grantor's spouse (i.e., irrevocable life insurance trusts).

Though there are other grantor-retained powers that make a trust a grantor trust, the above are the most common.

For income tax purposes, the grantor trust is treated as the same taxpayer as the grantor, even though the grantor trust is a separate legal entity and separate legal owner of the trust's assets. So, the grantor trust's income items are reported on the grantor's personal income tax return and the grantor pays the taxes.

If the grantor does not retain any grantor trust powers such as those listed above, and the trust is not a simple trust, it is a *complex trust*.

Does a trust file its own income tax return?

Yes, if the trust is a simple trust or complex trust, the trustee must file a tax return for the trust (**IRS Form 1041**) if the trust has any taxable income (gross income less deductions is greater than $0), or gross income of $600 or more.

For grantor trusts, it depends. A grantor trust may use the grantor's Social Security number as its taxpayer identification number, or it may obtain its own taxpayer identification number from the IRS. If a grantor trust uses the grantor's Social Security number as its taxpayer identification number, it does not need to file its own income tax return as all tax documents such as 1099s will be issued to the grantor directly to report on the grantor's individual income tax return. However, if a grantor trust has its own taxpayer identification number, it may have to file its own tax return for informational purposes only. The pro forma tax return identifies the trust as a grantor trust and includes a grantor trust letter that lists all income items that should be reported on the grantor's individual income tax return, so that the grantor can pay the taxes.

If the trust is its own taxpayer, does the trust also have to file a state income tax return and pay state income taxes as well?

Yes, if a state has tax jurisdiction over the trust, the trust will have to file a state income tax return and pay state income taxes in that state. Each state has its own rules regarding whether it has tax jurisdiction over a trust. Some states such as New York may tax a trust if the grantor resided in New York when the trust was funded, unless there are no New York trustees, no New York situs trust assets, and no New York source income. Other states like California may tax a trust if one of the trustees or beneficiaries is a California resident. Because each state has different rules for imposing income taxes on trusts, it is possible for a trust's income to be taxable in multiple states. However, if you know these rules, you can reveal opportunities to reduce or eliminate a trust's state tax liability. For example, if the grantor resided in New York when the simple or complex trust was funded, New York state tax liability may be eliminated by replacing a New York trustee with a trustee who is not a New York resident, as long as the trust has no New York situs assets or New York source income.

For a trust that pays its own income taxes, what deductions can the trust claim?

The usual deductions a simple or complex trust can claim on its tax return are for state tax paid, trustee fees, tax return preparer fees, and the income distribution deduction. Because a grantor trust is not considered a separate taxpayer, it cannot claim its own deductions.

Trustee Fees and Tax Return Preparer Fees

For trust expenses such as trustee fees and tax return preparer fees, only the portion attributable to taxable income is deductible. For example, if the trust's income consists of $10,000 in dividends and $5,000 in tax exempt interest, only two thirds of the trustee fees and tax return preparer fees are deductible.

Income Distribution Deduction

To determine the trust's income distribution deduction, you must first calculate the trust's distributable net income (DNI). DNI is defined by the Internal Revenue Code – generally, it is equal to total trust income (including tax exempt interest but excluding capital gains or losses), less deductions such as state tax paid, trustee fees, and tax return preparer fees.

If the trust's total distributions to beneficiaries is greater than DNI, the Income Distribution Deduction = DNI – tax-exempt interest.

If the trust's total distributions to beneficiaries is less than DNI, the Income Distribution Deduction = Total distributions – (Total distributions × tax-exempt interest / DNI).

If the trust claims an income distribution deduction on its tax return, the amount deducted gets passed to the trust beneficiary on a **Schedule K-1**, and the trust beneficiary must report the Schedule K-1 income items on his or her own personal income tax return.

How does a trust's income tax rates compare with an individual's income tax rates?

For the 2020 tax year, a simple or complex trust's income is taxed at bracket rates of 10%, 24%, 35%, and 37%, with income exceeding $12,950 taxed at that 37% rate. By comparison, a single person's income is taxed at bracket rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37%, with income exceeding $518,401 taxed at that 37% rate. Because the trust's tax brackets are much more compressed, trusts pay more taxes than individual taxpayers. Below are the 2020 tax brackets for trusts that pay their own taxes:

- $0 to $2,600 in income: 10% of taxable income
- $2,601 to $9,450 in income: $260 plus 24% of the amount over $2,600

- $9,450 to $12,950 in income: $1,904 plus 35% of the amount over $9,450
- Over $12,950 in income: $3,129 plus 37% of the amount over $12,950

What is the 65-day rule?

Under the 65-day rule, a trustee can make distributions to trust beneficiaries within 65 days after year-end and treat those distributions as if they were made in the previous tax year. The deadline for the distribution is March 6 (March 5 in a leap year). An irrevocable election must be made on the trust's income tax return to treat the distributions made within the 65-day window as made in the prior tax year. For tax year 2020, if trustees make distributions to trust beneficiaries before March 6, 2021, they can elect to treat those distributions as 2020 tax year distributions. The trustee would claim an income distribution deduction for these "65-day rule" distributions on the trust's 2020 tax return and shift some of the trust's 2020 income tax burden to the trust beneficiaries, who would be taxed at lower rates than the trust. Trustees may take advantage of the "65-day rule" when the trust's distributions to beneficiaries during the calendar year are less than the trust's DNI for that year. If that is the case, the trustee may make "65-day rule" distributions up to the trust's DNI to maximize the trust's income distribution deduction and shift the tax liability on those distributions to the beneficiaries.

Do Trust Beneficiaries Pay Taxes?

Beneficiaries of a trust typically pay taxes on the distributions they receive from the trust's income, rather than the trust itself paying the tax. However, such beneficiaries are not subject to taxes on distributions from the trust's principal.

When a trust makes a distribution, it deducts the income distributed on its own tax return and issues the beneficiary a tax form called a K-1. The K-1 indicates how much of the beneficiary's distribution is interest income versus principal, and thus, how much the beneficiary is required to claim as taxable income when filing taxes.[1]

Understanding Trusts and Beneficiaries

A trust is a fiduciary relationship whereby the trustor or grantor gives another party—the trustee—the right to hold property or assets for the benefit of a third party (usually the beneficiary).

Trusts are established to provide legal protection and safeguard assets, usually as part of estate planning. Trusts can ensure assets are properly distributed to the beneficiaries according to the wishes of the grantor. Trusts can also help to reduce estate and inheritance taxes as well as avoid probate, which is the legal court process of distributing assets upon the death of the owner.

Although there are several types of trusts, they typically fall into one of two categories. A revocable trust can be changed or closed at any time during the grantor's lifetime.

Conversely, an irrevocable trust cannot be amended or closed after it has been opened, including those trusts that become irrevocable upon the grantor's death. The grantor—by establishing an irrevocable trust—has essentially transferred all ownership or title of the assets in the trust.

There are various tax rules for beneficiaries of income from trusts depending on whether the trust is revocable or irrevocable—as well as the type of income the trust receives.

Interest vs. Principal Distributions

When trust beneficiaries receive distributions from the trust's principal balance, they do not have to pay taxes on the distribution. The Internal Revenue Service (IRS) assumes this money was already taxed before it was placed into the trust. After money is placed into the trust, the interest it accumulates is taxable as income, either to the beneficiary or the trust itself.

The trust must pay taxes on any interest income it holds and does not distribute past year-end. Interest income the trust distributes is taxable for the beneficiary who receives it.

The amount distributed to the beneficiary is considered to be from the current-year income first, then from the accumulated principal. This is usually the original contribution plus subsequent ones and is income in excess of the amount distributed. Capital gains from this amount may be taxable to either the trust or the beneficiary. All the amount distributed to and for the benefit of the beneficiary is taxable to him or her to the extent of the distribution deduction of the trust.

If the income or deduction is part of a change in the principal or part of the estate's distributable income, income tax is paid by the trust and not passed on to the beneficiary. An irrevocable trust that has discretion in the distribution of amounts and retains earnings pays a trust tax that is $3,011.50 plus 37% of the excess over $12,500.

Tax Forms

The two most important tax forms for trusts are the 1041 and the K-1. Form 1041 is similar to Form 1040. On this form, the trust deducts from its own taxable income any interest it distributes to beneficiaries.[2]

At the same time, the trust issues a K-1, which breaks down the distribution, or how much of the distributed money came from principal versus interest. The K-1 is the form that lets the beneficiary know the tax liability from the trust's distributions.

The K-1 schedule for taxing distributed amounts is generated by the trust and handed over to the IRS. The IRS, in turn, delivers the document to the beneficiary to pay the tax. The trust then completes Form 1041 to determine the income distribution deduction that is accorded on the distributed amount.

What Is a Trust Beneficiary?

A trust beneficiary is a person for whom—or for whose benefit—the trust is created; they stand to inherit from the trust at least some portion of its holdings. We say "person," but technically a beneficiary can be any recipient of a trust's largesse. Though individuals are the most typical, beneficiaries can also be groups of people or even entities—like a charity.

How Does a Beneficiary Get Money From a Trust?

Beneficiaries get money—officially known as distributions–from a trust in one of three basic ways:

- Outright distributions: receive the funds in a lump payment or two, with no restrictions
- Staggered distributions: receive the funds over a certain time period or at periodic intervals, often in a set sum each time; or after a specific event, such as graduation from college, reaching the age of majority, becoming a parent
- Discretionary distributions: receive the funds in amounts and at times determined by the trustee often in accordance with the grantor's instructions and stated wishes

Can a Trustee Remove a Beneficiary From a Trust?

Yes, a trustee can remove a beneficiary from a trust, though how easy it is to do so depends on whether the trust is revocable or irrevocable.

If the trust is a revocable living trust, and the trustee is the grantor (the person who set the trust up), then the trustee can amend the trust at any time. Such amendments include adding or removing beneficiaries.

But if the trust is an irrevocable one (whether it was established that way or became that way when the grantor died), it's a different situation. As the word "irrevocable" implies, the terms and features of the trust can't be changed—and that includes the named beneficiaries. So in most cases, a trustee cannot remove a beneficiary from an irrevocable trust.

Laws vary by state, but generally, the only way a trustee could remove a beneficiary is if the grantor (or creator) of the trust gave them a power of appointment—a special provision in the trust agreement that explicitly allows them to make such a change.

The Bottom Line

Whether beneficiaries pay tax on monies received from a trust depends on how the distribution is classified. If the funds are deemed as coming from the trust's income—that is, earnings on its assets—the beneficiary does owe income tax on them. Whether it's taxed as regular income or capital gains depends on the nature of the funds (cash, dividends, etc.) If the funds are considered part of the trust's principal, however, the beneficiary doesn't owe tax on them—because they're considered a return of money that presumably was already taxed before it went into the trust.

The IRS has established a sort of last in, first out (LIFO) pecking order for classifying distributions: The amount is considered to be from the current year's income first, then from the accumulated principal.

Trusts – tax status in Pakistani laws:

Formation of a 'trust' for which the Arabic term is 'Waqf' is a very old concept. This form of ownership was initiated and introduced by Hazrat Ali (AS) in Madinah and a 'trust' (waqf) mainly consisting of agricultural properties at Yanbu was formed in 6th or 7th Hijri for the welfare of general public. This concept was continued by the Muslim society when they ruled Spain and the famous Oxford University of the UK is formed under the same concept way back in 10th century AD. These were public trusts. There is a similar concept for 'private trusts'. The main difference is that in the latter case 'beneficiary' may not be the general public. The concept of trust relates to the settlement of ownership of assets for the person other than the settler. Under this concept, a person owning an asset transfers the same for a particular purpose in the manner that ownership and income from that property is used or to be used for specified private or public purpose(s), as the case may be.

This subject came under extensive discussion throughout the world including Pakistan, after the Panama Papers and the Paradise Papers. These revelations transpired that in most of the cases properties held outside Pakistan, were owned by 'private trusts' authored by persons being citizens and tax residents of Pakistan who originally held such properties. Accordingly, after the settlement of a trust such properties and income therefore did not appear as 'assets' or 'income' of that person for corporate, fiscal, foreign exchange and other purposes. There can be a very extensive debate on the subject in the following paragraphs. This concept has been discussed from taxation perspective with a particular reference to ownership of assets by a person who creates the trust and income therefrom. The person who creates a trust is described as author / settler of the trust. This article does not deal with the subject of veracity of the 'sources of money' through which a trust is formed. At this stage, the purpose is to identify the correct understanding of a trust ownership.

Salmond's Jurisprudence on the subject explained the concept (7th Edition - pages 284 to 286) as under:

"A Trust is a very important and curious instance of duplicate ownership. Trust property is that which is owned by two persons at the same time, the relation between the two owners being such that one of them is under an obligation to use his ownership for the benefit of the other. The former is called the Trustee and his ownership is trust-ownership; the latter is called the beneficiary and his beneficial - ownership.

The trustee is destitute of any right of beneficial enjoyment of the trust property. His ownership, therefore, is a matter of form rather than of substance and nominal than real. If we have to regard the essence of the matter rather than to the form of it, a trustee is not an owner at all, but amere agent. He is a person to whom the property of someone is factiously attributed by the law, to the extent the rights and powers vested in a nominal owner shall be used by him on behalf of the real owner. As between the trustee and the beneficiary, the law recognizes the truth of the matter; as between the two the property belongs to the later and not the former. But as between the Trustee and the third person the fiction prevails, the trustee is clothed with the rights of his beneficiary and is so enabled to personate or represent him in dealings with the world at large.

The purpose of trusteeship is to protect the rights and interests of persons who for any reason are unable effectively to protect them from themselves. The law vests those rights and interests for safe custody, as it were, in some other person who is capable of guarding them and dealing with them, and who is placed under a legal obligation to use them for the benefit of him to whom they in truth belong.

The chief classes of persons in whose behalf the protection of trustee -ship is called for, are four in number:

In the first place, the property may belong to persons who are not yet born; and in order that it may be adequately safeguarded and administered, it is commonly vested in the meantime in trustees, who hold and deal with it on account of unborn owners.

In the second place, similar protection is required for the property of those who lie under some incapacity in respect of the administration of it, such as infancy, lunacy or absence.

Thirdly it is expedient that property in which large number of persons are interested in common should be vested in trustees. The complexities and difficulties which arise from co ownership become so great as soon as the number of co-owner ceases to be small, that it is essential to avoid them and one of the most effective devices for this purpose is that scheme of duplicate ownership which we term a Trust.

Fourthly, when persons have conflicting interests in the same property (for example) an owner and encumbrance or different kind of encumbrances, it is often advisable that property should be vested in Trustees whose power and duty should be it is to safeguard the interests of each of the persons against the conflicting claim of the others."

In the case of a private trust, there is usually the question relating to a distinction between the settlements of property though the mode of formation of the trust and a properly documented will relating to such property. The primary differences have been identified in the following table:

TRUST	WILL
Setting up of trust involves transfer of property	No transfer of property is involved
Legal ownership is transferred to the trustees	No transfer of ownership to any person
Settlor, trustee and beneficiary - all three roles can be played by the same person	Properties are passed on through a Will only after the death of the person
Trust can be revoked only if there is a power contained in the trust deed or if all the beneficiaries agree	WILL can always be revoked during the lifetime of the person

Trust is a proper mode to handle the affairs, if there are issues in relation to compliance with 'inheritance' laws. In addition to the same, formation of a trust assures continuity of the desires of the settler.

From taxation perspective, the primary question is whether the property in trust and the income therefrom the asset/ownership or income of the settler / author is. The answer is not that simple, primarily on account of open-ended nature of trust form of ownership and accretion of income at various stages. Apparently, it can be seen as a mode of avoidance of tax compliance. This raises the following questions:

(i) Can a settler go scot-free after the trust creation?

(ii) What are his liabilities under the tax laws?

(iii) Can a settler escape from taxation altogether by transferring assets to a trust and thereafter plead that the income is diverted at source and he should not be bothered about it all?

(iv) Can a settler step out by contending that he has transferred the income to a trust and only because he has interest in the assets, he should not be taxed on the very same income?

(v) Can the Income Tax Authorities lift the veil of a trust and then still pursue their actions on the settler even though a valid trust is created by way of law under any jurisdiction in or outside Pakistan?

In this author's view, these are all well settled matters under the Income tax jurisprudence throughout the world, including India and Pakistan. There is no tax avoidance in the case of a properly executed irrevocable trust, whether formed in Pakistan or outside Pakistan.

The matter has been dealt with in the UK tax statutes and the same has been carried through in the Pakistan's Income Tax Act, 1922, Income Tax Ordinance, 1979 and the present Income Tax Ordinance, 2001 ('the Ordinance'). This subject is dealt with under Section 90 of the Ordinance. It is actually one of the few provisions where there is no change in text or context of the matter since inception in 1922. Section 90 of the Ordinance states as under:

> *90. Transfers of assets. - (1) For the purposes of this Ordinance and subject to sub-section (2), where there has been a revocable transfer of an asset, any income arising from the asset shall be treated as the income of the transferor and not of the transferee.*
>
> *(2) Sub-section (1) shall not apply to any income derived by a person by virtue of a transfer that is not revocable during the lifetime of the person and the transferor derives no direct or indirect benefit from such income."(emphasis is ours)*

When these provisions were introduced in UK then commenting on the object of corresponding legislation in England, Lord Macmillan said in Chamberlain v IR, (25 TC 317)

> "10. This legislation forms part of a code of increasing complexity, beginning with the Finance Act 1922, s 20, designed to overtake and circumvent a growing tendency on the part of taxpayers to endeavour to avoid or reduce tax liability by means of settlements. Stated quite generally, the method consisted in the disposal by the taxpayer of part of his property in such a way that the income should no longer be received by him, while at the same time he retained certain powers over, or interest in, the property or its income. The legislature's counter was to declare that the income of which the taxpayer had thus sought to disembarrass himself should, notwithstanding, be treated as still his income and taxed in his hands accordingly."(emphasis is ours)

Under Section 90 of the Ordinance, income which arises to any person (i) by virtue of any 'transfer' from assets if it remains to be the property of the transferor or (ii) by virtue of a revocable transfer of assets, is deemed to be the income of the transferor and taxed as his income. However, Section 90 of the Ordinance has no application where the income stood diverted by an overriding title, as a matter of fact, even before the accrual of income. Similarly, Section 90 of the Ordinance cannot apply where, under an agreement for the purchase of a business, the management, possession and the right to carry on the business is taken over by the taxpayer even before the execution of the conveyance. The assignment of a part of the right to receive income from the residuary property is legal and valid, and such assignment would not be covered by Section 90 of the Ordinance. All this discussion revolves around a primary question whether or not a settlement can be considered as revocable in substance. This question primarily arises in case of a 'discretionary trust' or in the case of a trust where settler is also the beneficiary. Nevertheless, this matter has also been thrashed out in detail in various decisions of the courts in the UK, India and Pakistan.

The matter as referred above also requires a distinction between a 'discretionary trust' and a 'revocable trust'. This question can be phrased in another manner by saying whether or not a discretionary trust is by nature a revocable trust. This aspect was discussed in the decision of the Supreme Court of India in a case reported as 201 ITR 611. The Supreme Court reproduced the definition of a discretionary trust from Snell's Principles of Equity as under:

> "A discretionary trust is one which gives the beneficiary no right to any part of the income of the trust property, but vests in the trustees a discretionary power to pay him, or apply for his benefit, such part of the income they think fit... . The beneficiary thus has no more than a hope that the discretion will be exercised in his favour."

This aforesaid decision and many others on the subject have unequivocally decided that a discretionary trust 'ispo facto' does not make a settlement of the trust as a revocable trust. This particular case law deals with the subject of foreign trust created by a settler. The Gujarat High Court as the decision reported as 326 ITR 594 elaborated the matter on page 624 as under:

"So far as the years under appeals are concerned, the assessee has been seriously challenging inclusion of income from the UK trusts in his hands stating therein that neither distribution has been taken place nor the same has been received by him. The assessee has also produced the accounts of the trusts wherein it is specifically stated that the income has been retained by the trustees and it was brought forward to the next years. It was also stated in such statement of accounts that the tax has been paid by the trustees of the U.K. trusts on the income so earned in the U.K.. It appears that any of the authorities below, including the Tribunal has not considered this vital aspect of the matter and proceeded on the footing that the facts are identical and that the notes are similar to the notes of earlier years. If the income were retained by the trustees and it has not been distributed, nor has it been received by the assessee and no evidence has been brought by the Department to show that the same has been received by the assessee in India, such income cannot be taxed in the hands of the assessee. Section 5 of the Act has also no application. When the income has neither accrued nor received by the assessee, nor has it been received or accrued on his behalf either in India or outside India, such income cannot be taxed under section 166 of the Act as it is not the income receivable. Section 166 of the Act can be invoked only when the income is received by the assessee. Unless and until the trustees exercise the discretion and distribute the income in favour of any of the beneficiaries, ie the assessee, such income cannot be said to be received by the assessee. Taking any view of the matter, it cannot be said that the income has been either received by or accrued to the assessee.

The aforesaid description leads us to the conclusion that an irrevocable trust has been recognized as a valid transfer of assets for income tax purposes also. In this context whilst handling the debate on the Panama Papers and the Paradise Papers there has to be proper apprehension of laws as otherwise a very valid provision of law may be misunderstood. The summary conclusion on the matter is as under:

-If a Pakistani citizen or a tax resident transfers a property within Pakistan or outside Pakistan to an irrevocable trust formed in Pakistan or outside Pakistan then such property does not represent an 'asset' of the settler for tax or any other legal purposes;

-The income arising from the property held outside in a trust formed outside Pakistan does not represent income of the named beneficiary (even if the beneficiary is a tax resident of Pakistan) unless the same is received by that particular beneficiary; and

-A foreign trust, formed outside Pakistan, by a Pakistani citizen holding Pakistani asset is not required to file return of income if there is no Pakistani source of income from a Pakistani asset or assets during the year under consideration.

Trusts – tax status in India with Case laws:

CONCEPT OF TRUST:

The Indian Trusts Act 1882 ('Trusts Act') is the principal legislation which recognizes and gives legal basis to the concept of trust as was understood in Britain and its colonies. The Trusts Act (framed and passed prior to independence) is the main law governing the formation of trust, the rights and obligations of trustees, settlors and the beneficiaries of a private trust. The trusts governed by the Trusts Act are the private trusts, formed by individual or body corporates, for the benefit of finite identified classes of beneficiaries. The Trusts Act defines trusts as 'an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner'.

Public trusts set up in India are categorized into charitable and religious trusts and are governed by the Charitable and Religious Trusts Act 1920, the Religious Endowments Act 1863, the Charitable Endowments Act 1890 and are additionally regulated by specific state legislations such as the Maharashtra Public Trusts Act 1950 and the Gujarat Public Trusts Act 1950. The object of these trusts is one of charity, promoting education, art, culture, spreading religious and spiritual awareness and other objects of public good for the benefit of the public at large or a large section of the public.

Private trusts set up under the Trusts Act need to be registered under the Registration Act 1908 in the event immovable property is devolved on such private trusts.

Public trusts set up in India and declared through a non-testamentary instrument, apart from any state specific registration, need to be compulsorily registered under the Registration Act 1908.

While Indian laws do not recognise trusts as a separate legal entity, they recognise trusts as an obligation of the trustee to hold and own the property, not as an absolute owner (ie as both legal and beneficial owner), but to use and manage the trust property for the benefit of the beneficiaries.

There are three parties to a trust - the settlor, being the person who creates the trust; the beneficiary, for whose benefit the trust has been created; and the trustee, who is appointed by the settlor to manage the funds and affairs of the trust. A trust (under the Trusts Act) could either be discretionary or determinate / non-discretionary. The trustee of a discretionary trust may, at his discretion, decide the share of the beneficiaries from within the named beneficiaries and the quantum and time of distribution of the trust property and / or income to the beneficiaries. With a determinate / non-discretionary trust, the share of the beneficiaries in the trust property and its income is pre-determined and spelt out in the trust deed. A person may be a settlor and a trustee, or a settlor and a beneficiary, or a trustee and a beneficiary but such person can only be all three if he is one of many beneficiaries. While there is no such limitation provided in the Trusts Act, the Gujarat High Court has held that there cannot be a case where the creator of the trust would also be the trustee and also the sole beneficiary, because in such cases a man cannot enforce a trust against himself'.

It is also pertinent to highlight a particular issue with respect to appointment of the trustee. Under the Trusts Act, the beneficiaries have the right to have the trust property be protected and administered by 'proper' persons. The Trusts Act goes on to elaborate that such proper persons do not include persons residing permanently outside India or persons domiciled abroad. This provision has given way to discussions on whether a non-resident Indian can be appointed as a trustee. It should be borne in mind that, as per the Trusts Act, this provision is subject to the provisions of the trust deed and, with the consent of the beneficiaries, the trust can be managed by a non-resident Indian trustee. However, the same has to be tested in the context of exchange control laws in India as to whether a non-resident trustee can hold properties in India, since the ownership of the trust property is legally vested in a trustee.

MAIN TAXES IN RESPECT OF TRUSTS

The domestic income tax law in India is governed by the IT Act. Indian residents are subject to tax on their worldwide income (ie based on the residence rule) whereas non-residents are subject to tax in India only on income that is sourced in India (ie based on the source rule).

Income is taxed in India under five heads, namely, income from salary, income from house property, income from business or profession, income from capital gains, and income from other sources. In addition to direct taxes, India also levies a number of indirect taxes such as excise duty, Goods & Services Tax, sales tax, value added tax etc. Even if there may not be any income tax payable, due to exemption or due to the income not being above the minimum threshold amount for attracting tax, indirect taxes, by their very nature, are payable by all. Furthermore, on the instrument of transfer of property (movable or immovable, as the case may be), stamp duty is payable as prescribed under the Indian Stamp Act 1889 or the relevant state-specific stamp laws.

As noted above, tax liability in India is determined either through residence of a taxpayer or the source of income with respect to which the tax liability arises. There are different rules for determining residency for different entities and taxable units.

Whereas individuals, body corporates, companies, HUFs, partnerships (both general and limited liability partnership) as well as unincorporated bodies of individuals or associations of persons who come together for a particular business or venture are the taxable entities or units, a ‘trust’ per se is not a taxable unit. Therefore, determination of residence of trust in India is a tricky issue. In general, if neither the trustee nor the protector, or the person who has the ability to control the management of the assets of the trust fund and determine their distribution, is not located in India at any time during the financial year, and the trust is not subject to Indian laws, then the trust should not be considered a resident in India. For the purpose of ascertaining the residency of the trust, the residence of the beneficiaries also has some bearing. In order for an offshore trust not to be subject to tax in India based on the source rule, none of its assets or source of income should be in India. A non-natural person is considered to be resident in India, if the control and management of such non-natural person lies in India.

CASE LAWS:

TRUST DEED

Mrs. Leela Nath vs Commissioner of Income-Tax on 20 August, 1980

1982 134 ITR 507 Cal

In this reference under Section 256(1) of the I.T. Act, 1961, the following question has been referred to this court :

" Whether, on the facts and in the circumstances of the case, and on the proper interpretation of the trust deed the Tribunal was justified in holding that the said trust is a revocable trust ? "

18. In this connection, it is necessary to bear in mind the entire scheme of Sections 60 to 63. Section 61 makes all income arising to any person by virtue of a revocable transfer of assets chargeable to income as the income of the transferor. Section 62

stipulates that the provision of Section 61, that is to say, addition of income by virtue of a revocable transfer of assets to the income of the transferor should not apply to income arising to any person by virtue of a transfer by way of, inter alia, a transfer which is not revocable during the lifetime of the beneficiary or made before the 1 st April, 1961, which is not revocable for a period exceeding six years. But Sub-section (1) of Section 62 is hedged by a proviso, which is applicable provided that the transferor does not derive any direct or indirect benefit from such income in either case. If the transferor does derive, in fact, direct or indirect benefit from a transfer and even if the conditions of Sub-clause (i) or (ii) of Sub-section (1) of Section 62 are fulfilled, it would be treated as a revocable trust. In this case; it is again necessary to emphasise that in view of the question that is posed before us and1 in view of the arguments that the Tribunal had occasion to consider, it is not necessary for us to examine whether the transferor actually derived any direct or indirect benefit from the income arising out of the transfer because we are only concerned with whether the transfer, that is to say, the deed of transfer, was a revocable one by fulfilling either of the conditions stipulated in Clause (a) and Clause (b) of Section 63 of the Act. Indeed, an argument might have been possible that having used an interest-free loan out of the transferred asset the assessee had, in fact, in the background of the case, derived direct or indirect benefit. Whether such an argument would have been sound or not, it is not necessary for us to decide or discuss because that is not within the ambit of the question posed before us. As we have mentioned before, in order to be a revocable transfer under Section 63 of the Act, the transfer deed must contain a provision for retransfer directly or indirectly of the whole or any part of the income which must go to the transferor or the right to reassume power directly or indirectly over the whole or any part of the income or assets. This aspect, in our opinion, in view of the clauses mentioned in the deed, on principle, cannot be said to be a revocable trust under Section 63 of the Act (sic). We have set out the relevant clauses. If, as we have indicated, Clause 8 of the deed of transfer is construed to mean that the power for the discretion to invest the money of the trust did not include the power to give an interest-free loan, the trustees acted in breach of the terms of the deed, for a benefit derived by the settlor, where the trustees acting in derogation or in breach of the deed of transfer, it cannot be said that the deed of transfer was revocable because it contained a term permitting either retransfer directly or indirectly over the whole or any part which must go to the transferor or the right to reassume power directly or indirectly over the whole or any part of the income or assets. Even if we proceed on the basis that the power to invest absolutely includes the power to grant an interest-free loan even then, in our opinion, no provision under Clause 9 entitles the transferor or the settlor to transfer directly or indirectly the whole or part of the income or the assets to the transferor. It may be that it gave a right to the transferor or the settlor or one who was the owner to be a borrower of certain money. But that cannot be construed to mean that it conferred a right to retransfer, that is to say, hand over the assets or the income in the same capacity that the transferor held before the deed of transfer, nor can it be construed to permit the transferor to reassume, that is to say, to take the sum in the same capacity or in the same capacity which he had before the transfer, directly or indirectly, or either whole or part of the income or assets. Learned advocate for the revenue emphasised that Clause 8 permitted or entitled the trustees to invest the property in such manner in their absolute and uncontrolled discretion and it also excluded the operation of the restriction prescribed by the Trusts Act or any other law pertaining thereto. It might be that it gave an uncontrolled right to the trustees to reinvest but it did not permit or give any power either to transfer or to hand over the property in the same capacity, that is to say, as owner of either the income or the asset or the property in the same capacity as that of the transferor. If Clause 8 is read in conjunction with -cl. 9 then, in our opinion, it cannot be construed that there was any right which the settlor reserved in the deed of transfer by virtue of which it could be said that he had reserved the rights contemplated under sub-els. (i) and (ii) of Clause (a) of Section 63 of the Act. This construction, in our opinion, is well settled by judicial decisions. The first decision to which we must refer is the decision of the Division Bench of this court in the case of CIT v. Sir S.M. Bose [1952] 21 ITR 135. There, the court was concerned with the first proviso to Section 16(1)(c) of the Indian I.T. Act, which we have set out hereinbefore, and which corresponds to Section 63(a), Clauses (i) and (ii). But what was one in proviso to Clause (c) of Sub-section (1) of Section 16 of the Indian I.T. Act, 1922, has now been placed in two sub-clauses being Sub-clauses (i) and (ii) of Clause (a) of Section 63 of the Act of 1961. The Division Bench of this court held that the first proviso to Section 16(1)(c) of the Indian I.T. Act, 1922, only contemplated cases where the settlor could lawfully reassume power over the income or the assets. There, what happened was that the assessee had settled certain property on himself as a trustee to hold it in trust for his daughter. The deed, which was in the ordinary form, an out and out trust on the English model, provided that the trustee was to take possession and after paying the outgoings the income of the trust estate was to be paid to his daughter during the term of her natural life for her sole and separate use. The deed also made provisions as to how the income was to be dealt with on the death of the daughter. But the settlor retained no right whatsoever over the corpus or the income, and he had no power of revocation. Clause 3 of the deed provided that " as long as the present trustee, viz., the settlor or the persons, named as trustees in addition or substitution, shall act as trustees, they shall not be accountable to any of the beneficiaries under these presents relating to his or their dealings as to the income of the trust estate ". The question was whether the income from the trust properties was taxable in the hands of the assessee as his income by virtue of the provisions of s. I6(1)(c) of the Indian I.T. Act, 1922. It was held that the settlor by the trust deed put the income for ever out of his control and that being so the income from the trust properties could not be assessed as part of the income of the assessee under Section 16(1)(c). Clause 3, which we have set out hereinbefore, did not, according to the Division Bench, give the settlor a control over the income. It was merely a provision limiting the rights of the beneficiary to question certain acts of the trustee. Provisions made in the deed to prevent frivolous litigation and to prevent questioning the bona fides of the trustees did not have the effect of giving the settlor a right to reassume power directly or indirectly over the income or assets. Similarly, in our opinion, in the instant case before us, the discretion give to the trustees " to invest the property of the trust in such manner as they, in their absolute and uncontrolled discretion, may consider proper" or that this power shall not be subject to any restriction as prescribed in the Trusts Act of 1882 or any other law pertaining te the trustees in relation to the powers of the trustees of investment or otherwise, cannot be construed to mean that the settlor had the right to reassume power directly or indirectly over the income or the assets as an owner. This principle was again enunciated by the Supreme Court in the case of CIT v. S. Raghbir Singh .

40. However, we are not concerned in this case with the question whether the very fact that the trustees could put an end to the trust with the concurrence of the major beneficiaries made the power revocable or not, in view of the nature of the power given in the present trust deed. For the reasons aforesaid we must, therefore, say that on both aspects we are not able to accept the contention of the revenue that the trust deed contained such provision which would make it a revocable trust in terms of Sub-clause (i) or Sub-clause (ii) of Clause (a) of Section 63 of the I.T. Act, 1961.

ENTIRE INCOME

Mohammed Omer Family Trust vs Income-Tax Officer on 21 October, 1991

1992 40 ITD 1 Hyd

(iv) the trust has been created bonafide by a person carrying on business or profession exclusively for the benefit of his employees.

The bill seeks to provide that the aforesaid provisions will not apply in a case where the income, of a discretionary trust consists of, or includes, profits and gains of business. In such cases, the entire income of the trust would be charged at the maximum marginal rate of tax, except in cases where the profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him. In such cases, the income of the discretionary trust would be charged to tax at normal rates applicable to individuals and not at the maximum marginal rate of income-tax.

While interpreting Section 161(1A) in para 30, it is held by my learned brother "that Section 161(1A) contemplates in very clear and unequivocal terms its applicability with reference to the business profits of the trust". However, way down in para 31, it is held by him "that the sweep of the section attracts the entire income of the trust as a whole". These observations require reconsideration. Then he concluded that the tax is chargeable on the whole of the income of the trust in the hands of the representative assessee at maximum marginal rate. With respects, I disagree. In a case where the income from trust of which the trustee is a representative assessee on behalf of or for the benefit of others, includes profits and gains of business, the crucial question is whether the maximum marginal rate should be applied on the entire income of the trust as such or with reference to the entire share income of each of the beneficiaries individually who are known and whose shares are determinate. In my view, in a case of this type, after ascertaining the income from the trust, the same should be apportioned to the different beneficiaries in accordance with their respective shares and then tax at the maximum marginal rate should be levied on the shares of each of the beneficiaries in the hands of the representative assessee.

1. Whether in the facts and circumstances of the case, the assessments on the trustee as an Association of persons were justified.

2. In a case where the beneficiaries are known and their shares are determinate, where the total income includes income from profits and gains of business, whether the maximum marginal rate of tax is to be applied on the entire income of the trust as a single unit for assessment in the hands of the trustee or whether the maximum marginal rate is to be applied in the hands of the representative

assessee with reference to the entire share income of each of the beneficiaries individually? This involves the interpretation of Section 161(1A).

(iv) the trust has been created bona fide by a person carrying on business or profession exclusively for the benefit of his employees.

The Bill seeks to provide that the aforesaid provisions will not apply in a case where the income of a discretionary trust consists of, or includes, profits and gains of business. In such cases, the entire income of the trust would be charged at the maximum marginal rate of tax, except in cases where the profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him. In such cases, the income of the discretionary trust would be charged to tax at normal rates applicable to individuals and not at the maximum marginal rate of income-tax.

TRUSTEE

Sri Sri Sri Lakshamana ... vs State Of Andhra Pradesh & Anr on 24 January, 1996

1996 AIR 1414, JT 1996 (1) 535

Shri P.P. Rao, the learned senior counsel for the State, resisted these contentions. He conceded that though the definition of a trustee in Section 2(29) includes mathadhipati insofar as his right to administer and manage the properties of the math are concerned, the Act does not impinge upon his right as a spiritual head of math. The abolition of hereditary rights by Section 16 does not include the right of mathadhipati. Mathadhipati in most cases is nominated by his predecessor. mathadhipati is a sanyasi who has renounced worldly affairs and has severed his ties with natural family. Therefore, there is no scope for hereditary succession to the office of a mathadhipati. The hereditary trustee defined under Section 2(16) and abolished by Section 16 does not, therefore, include mathadhipati. The concept of hereditary trustee defined in the predecessor Act 17 of 1966 is the same as in the Act. Section 16, therefore, has no application to a mathadhipati.

Chapter V does not per se attempt to regulate the propagation or preaching of the tenets by Mahant or of the math or religious beliefs to which the math is founded or it seeks to propagate. The definition of the mathadhipati for the purpose of the Act is expressly confined only in relation to the administration and management of a math or specific endowment attached to the math and vested in him as mathadhipati. Mahant is not a mere manager or custodian of the property. In his office as spiritual head, he has power to dispose of certain properties only for the benefit of the institution, incur expenditure for the math, to carry on religious worship for the disciples and to maintain himself consistent with his office. Though he has undoubted power to apply the funds of the institution, it would always be subject to certain obligations and duties equally governed by customs and usage of the institution. By operation of Section 48, Section 18 to 22, 25 and 28 in Chapter III of the Act shall not apply to the maths or specific endowment attached thereto. Though Section 2(29) defines `trustees to include mathadhipati, in the light of Section 47, by juridical metamorphosis, Mahant is a trustee of the math in relation to the management of the property of the math or the specific endowment attached to the math. He has to discharge the duties of a trustee and is answerable as such. The definition of "trustee" was used to reiterate the position he holds in general law of trust in relation to maths and in law he is enjoined to hold it as trustee. However, the word `trustee' does not include his right as a spiritual head of the math or to be a hereditary trustee. The definition of "hereditary trustee" under Section 2(16) which was abolished under the Act, therefore, does not apply nor it includes a Mahant who is spiritual head nominated by his predecessor mathadhipati or regulated under the Act for the reasons stated by Shri Rao to which we agree as it is axiomatic that office of mathadhipati is not hereditary or devolved by succession. In most cases it is regulated by nomination by his predecessor under the Act; and in the absence of nomination, by consultation with Mahant of similar maths.

TRUST PROPERTY

Bihar State Board Of Religious ... vs Raj Ratan Gir And Ors. on 24 July, 1967

1969 (17) BLJR 63

1. This appeal by the defendant first party, the Bihar State Board of Religious Trusts, hereinafter referred to as 'the Board' arises out of a suit for a declaration that the properties described in schedule B of the plaint were private Trust

property of the plaintiffs and defendant No. 2 and were not 'trust property' appertaining to a 'religious trust' as defined in Sections 2(P) and 2(L) respectively of the Bihar Hindu Religious Trusts Act, 1950, hereinafter referred to as 'the Act' and for a further declaration that the order dated the 30th May, 1958, passed by the Authority appointed under Section 43 of the Act was without jurisdiction and not binding on the plaintiffs.

4. The trial court has held that the suit, as framed, was maintaianable that the properties in suit were private trust properties of the plaintiffs and defendant No. 2 and did not appertain to a 'religious trust' as defin-ed in Section 2 (1) of the Act, and, as such, the Act was not applicable to the suit properties at all, that the defendant-appellant had no jurisdiction to take any action in respect of the suit properties under the Act, and, therefore, the impugned order dated the 30th May, 1958 passed under Section 43 of the Act was not binding on the plffs., and finally that the suit was not barred by limitation. On the above findings, the suit has been decreed. Hence, this appeal by defdt. No. 1.

6. 'Trust Property' and 'religious trust' are respectively defined in Sections 2(p) and 2(1) of the Act. According to the definition, 'trust property' means the property appertaining to a religious trust; and, 'religious trust' means "any express or construc-tive trust created or existing for any purpose recognised by Hindu law to be religious, pious or charitable, but shall not Include a trust created ac-cording to the Sikh religious or purely for the benefit of the Sikh community and a private endowment created for the worship of a family idol in vvhicirthe public are; riot Interested". Section 3 provides, inter alia, that the Act shall apply to all religious trusts, Whether created before or after the commencement of the Act; The decision of the Supreme Court in the case of Mahanth Ram Saroop Dasji v. S.P. Sahi is an authority for the proposition that the provisions of the Act do not apply to any private religious trust at all. Before dealing with the contention, raised on behalf of the appellant, it will be useful to read Sub-section (1) of Section 43 of the Act in so far as it is relevant for our purpose in the context of the definitions of 'trust property' and 'religious trust', and the decision of the Supreme Court, referred to above, Sub-section (1) of Section 43 (minus the proviso thereto which is not relevant for our purpose) reads as under:

43. Decision of disputes as to whether any immovable property is a trust property- (1). All disputes as to whether any immovable property is or is not a trust property shall be inquired into, either on its own motion or on application, by the authority appointed in this behalf by the State Government, by notification, in the Official Gazette;

It appears to me that Sub-section (1) of Section 43 on its express terms refers to disputes in connnection with the question whether one or more items of immovable property was a trust property or not or appertained to a trust property. It does, not include within its ambit the determination of the question as to the nature of the propetty itself, namely, whether a property in question was a trust property as defined in the Act or was a property which appertained to a private religious trust. The scope of Section 43 has been the subject matter of a Bench decision of this Court in Bihar Religious Trust Board v. Mahanth Jaleshwar Gir I.L.R. 46 Pat. 223, where the view which has been taken is that "if a dispute was in regard to the nature of the trust itself, Section 43 was not at all attracted and that neither the Board nor the Trustees nor any other person could approach the Authority for a declaration that a particular endowment or trust or institution was a public trust and not a private one or vice-versa. I find myself in respectful agreement with this view, and, in the circumstances, it is not necessary to further discuss this matter. In the instant case, at the instance of the Special Officer, Bihar Hindu Religious Trust Board, Patna, the Authority appointed""Under Section 43 of the Act has passed the impugned"' order dated the 30th May, 1957 holding that the Math, its temple and the deities and the properties attached thereto were in the nature of the public religious trust property (vide Ext. D). On the scope and ambit of Section 43, it was neither open to the Special Officer, Bihar Hindu Reli gious Trust Board, Patna,' who approached the Authority for any such declaration or order, nor was it competent for the Authority to make the aforesaid order. It, therefore, follows that the impugned order passed by the Authority appointed Under Section 43 of the Act on the 30th May, 1958 was wholly without jurisdiction. Upon this con elusion, the contention that the suit was barred under the special rule of limitation provided in Sub-section (5) of Section 43 must fail on the simple ground that the said rule of limitation as provided for in Sub-section (5) of Section 43 of the Act can be attracted to only such orders as can be passed by the Authority Under Section 43 of the Act, and not to orders which he had no jurisdiction to pass or make. The first contention accordingly, fails.

"CHARITABLE TRUST" "PROFIT" "BUSINESS" "NATURE"

Tor Steel Research Foundation vs Income-Tax Officer on 23 April, 1992

1992 42 ITD 39 Kol

2. The question posed before us for decision is whether the assessee-trust is liable to be assessed at the maximum marginal rate of tax under Section 164(1) of the Act as contended by the Revenue or whether it is liable to be assessed at the normal rates applicable to an Association of Persons as per Section 164(2) of the Act, a position canvassed by the assessee. We may make it clear that the assessee does not claim total exemption in respect of the income under Section 11 of the Act. It is common ground that the assessee has not complied with the elaborate procedure prescribed by Section 12 of the Act and that it has not also satisfied the stringent requirements of Section 11. What all the assessee claimed - and this is disputed by the Revenue - is that it should be assessed in the status of an AOP at the normal rate of tax, since it is a public charitable trust, as per Section 164(2).

7. We have carefully considered the rival submissions. We have perused the paper book, the orders of the departmental authorities and have also studied the decisions cited before us. In our opinion, the assessee is entitled to succeed in the appeals. We set out the reasons for our conclusion in the succeeding paragraphs.

9. We have now to examine whether the assessee falls within the ratio of the decision of the Supreme Court in Surat Art Silk Cloth Mfrs. Association's case (supra). It was held in that decision that the last ten words in Section 2(15) of the Act qualify only the words "any other object of general public utility"; it is the assessee's case before us that it falls within this residuary object. It was further held in that decision that it is the object of the trust that should not involve the carrying on of any activity for profit and that profit-making is not taboo so far as accomplishment of the object is concerned. In order to test whether the object itself included an activity for profit or only the accomplishment thereof, the "predominant object" theory was propounded. His Lordship, Bhagwati, J., (as he then was) said "Where an activity is not pervaded by profit motive but is carried on primarily for serving the charitable purpose, it would not be correct to describe it as an activity for profit" just because profit results. The same sentiments were expressed by His Lordship Pathak J. (as he then was) when he said that if the purpose is charitable, the attainment of the purpose need not rigorously exclude any activity for profit. However, if the predominant object was profit making, even though the object is charitable, there can be no charitable purpose.

10. Applying the above test to the instant case, it is clear that the predominant object of the assessee is not profit making, but profit is only used as a means to attain the object, viz., carrying on of the research activity in specialised twisted steel and propagating the results of the research. The power given to the trustees by clause 1 (b) of the trust deed to charge research fees from persons who wish to

avail of the fruits of the research activity from the assessee, as they decide from time to time, is subservient to the object contained in clause1(a). In fact, it is not an object at all as erroneously thought by the departmental authorities. It is only a power given to the trustees to ensure income for the trust so that there is no difficulty in accomplishing its object contained in clause 1 (a). This part of clause 1 (b) must be dissected from the earlier part of the said clause which speaks of communication of the results of the research and development efforts and from clause 1 (a). The departmental authorities have mixed up the means with the ends. As His Lordship Justice Balasubrahmanyan stated in Addl. CIT v. Gangabai Charities [1983] 142 ITR 718 (Mad.) (at page 735): "what the law requires is that a trust should not have any object of general public utility which involves, as an object, the carrying on of any activity for profit. The law does not frown against any activity for profit being carried on by a charitable trust as a means of furthering its objects, the objects themselves being indubitably charitable in nature." A similar "mixing up" was exposed by the Supreme Court in Andhra Pradesh State Road Transport Corpn.'s case (supra) referred to by Mr. Bajoria during the course of his argument. In that case, an argument was raised by the Revenue that even as per Section 22 of the Road Transport Corporations Act, the Corporation (assessee) was expected to carry on the operations on "business principles" and, therefore, the assessee could not be held to carry on an object of general public utility. Dealing with this contention, the Supreme Court held at page 10 of the Report, as follows :

The submission founded upon Section 22 is based upon a misunderstanding of what that section provides. A road transport corporation cannot be expected or be required to run at a loss. It is not established for the purpose of subsidising the public in matters of transportation of passengers and goods. The objects for establishing a road transport corporation are those set out in Section 3 of the RTC Act which we have already reproduced above. Section 18 shows that it is the duty of a road transport corporation to provide, secure and promote the provision of an efficient, adequate, economical and properly co-ordinated system of road transport services in the State. No activity can be carried on efficiently, properly, adequately or economically unless it is carried on on business principles. If an activity is carried on on business principles, it would usually result in profit, but, as pointed out by this court in Surat Art Silk Cloth Manufacturers Association's case [1980] 120 ITR 1 (SC), it is not possible so to carry on a charitable activity in such a way that the expenditure balances the income and there is no resultant profit, for, to achieve this, would not only be difficult of practical realisation but would reflect unsound principles of management. What Section 22, therefore, does when it states that it shall be the general principle of a road transport corporation that in carrying on its undertakings it shall act on business principles is to emphasise the objects set out in Section 3 for which a road transport corporation is established and to prescribe the manner in which the general duty of the corporation set out in Section 18 is to be performed. It is now firmly established by the decisions of this court in Surat Art Silk Cloth Manufacturers Association's case [1980] 121 ITR 1 (SC) and Bar Council of Maharashtra's case [1981] 130 ITR 28 (SC), that the test is What is the predominant object of the activity - whether it is to carry out a charitable purpose or to earn profit?" If the predominant object is to carry out a charitable purpose and not to earn profit, the purpose would not lose its charitable character merely because some profit arises from the activity.

This decision establishes two things : (i) it is not possible to so carry on a charitable activity in such a way that the expenditure balances the income and no surplus is left and (ii) this would be impractical and also would reflect unsound principles of management. It was not suggested in the present case either before us or by the departmental authorities in their orders that the trustees had fixed the income with the object of profit-making. In the absence of such a plea, we have to only come to the conclusion that profit is only an incident in the process of accomplishment of the object of the trust and, therefore, is not the predominant motive. It, therefore, follows that the assessee's case falls squarely within the ratio laid down by the Supreme Court both in Surat Art Silk Cloth Mfrs. Association's case {supra) and in Andhra Pradesh State Road Transport Corpn.'s case (supra).

11. We may notice that the Calcutta High Court has, in CIT v. Sangit Kala Mandir Trust [1987] 166 ITR 217, held that if the primary and dominant object was of general public utility, the clause empowering the trust to carry on business should be read in the context of the main object and must be held to be ancillary and incidental to the carrying on of the main object. The principle of this decision is applicable with full force to the present case.

12. A few minor points raised by Mr. Roy for the Department have to be disposed of. He stated that Dr. Mohanty was given wide powers under Clause 18(d) of the deed of trust. But that is not correct. The said clause merely stated that he was to exercise all the powers of the trustees so long as no additional trustees were not

appointed. There is nothing obnoxious about the clause. The powers conferred upon him were powers of management and day-to-day administrations of the trust. It was not suggested that he was given the powers of disposal over the income or assets of the trust towards purposes other than those stated in the objects clause of the deed of trust. The other point made was that the employees, including Mr. Mohanty, were given benefits such as insurance, medical benefits etc. This point is also not relevant in deciding the issue whether the assessee is a charitable, non-profit making trust. Even a trust, we believe, have to take good care of its employees, specially when the employees are men of letters, many of them highly trained in research studies. Even if the Revenue is of opinion that such benefits are excessive, there are provisions in the IT Act to control them, which may be invoked if the necessary conditions are present. We are not convinced that these two points argued by Mr. Roy have anything to do with the question posed for our decision.

13. We may also mention that the paper book filed by the assessee before us contains a number of pages which were devoted to proving the fact that the assessee was carrying on research activities in the field of torsteel for a long time. Paper-clippings, write-ups, messages from the Hon'ble Minister for Steel & Mines etc., are found in those pages. We have not discussed them in detail in this order, since the fact that the assessee was carrying on these activities has not been doubted by the Department.

14. For the reasons set out above, we are of the view that the assessee is a public charitable trust assessable at the rates applicable to an Association of Persons under Section 164(2) of the Act and not at the maximum marginal rate under Section 164(1). The orders of the CIT passed under Section 263 of the Act for the assessment years 1981-82 and 1982-83 are set aside and the assessments restored for these years. The order of the CIT(A) passed for the assessment year 1983-84 is reversed.

15. In the result, the appeals are allowed.