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News Alert
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Beneficiaries held not taxable in respect of income of overseas discretionary trusts not distributed or received by them

In brief

The Supreme Court (SC) held in the case of Estate of Late HMM Vikramsinhji of Gondal¹, that the taxpayer, a beneficiary of a discretionary trust, was not assessable in respect of income of the trust until such income was disbursed by the trustees.

Facts

- The ex-Ruler of Gondal, Vikramsinhji, executed two deeds of settlement (trust deed) in the United Kingdom on 1 January 1964 for the benefit of (a) the settlor, (b) his children, and (c) the wife or widow of (a) or (b).

- The settlor also appointed a trustee for the two trusts who, under the trust deed, had the power to exercise discretion to disburse the income to the beneficiary. However, the trust deed also provided that the entire income of the trust shall belong to, and be paid to, the settlor during his lifetime, and after his death, to his elder son and then to other descendants.
- During his lifetime, the settlor included the whole of the income arising from these trusts in his returns of income and wealth.
- After the settlor's death, the said income was also included in the income tax and wealth tax returns filed by his son Jyotendrasinhji, the taxpayer in the present case, for assessment year (AY) 1970-71.

¹Commissioner of Wealth-tax v. Estate of Late HMM Vikramsinhji of Gondal [TS-258-SC-2014]

- Thereafter, the taxpayer took the stand that income from these trusts was not includible in his income. The taxpayer also took the stand that inclusion of the said income in the returns submitted by his father for AYs 1964-65 to 1969-70 and by himself for AY 1970-71 was made under a mistake.
- Hence, the taxpayer made an application to the Income-tax Settlement Commission (ITSC).

Taxpayer's contention

The trust was a discretionary trust and since the trustees had not exercised their discretion, no income ever arose or accrued to the settlor or the taxpayer under the trust deed.

Revenue's contentions

- Perusing the trust deed, the ITSC had held that since additional trustees had not been appointed, the entire income flowed to the settlor during his lifetime and after his death to his elder son, the appellant herein. Thus, these settlements were in the nature of specific trusts.
- Thus, the ITSC concluded that the said income was rightly included in the total income of the settlor and the taxpayer during the respective AYs.

Supreme Court Ruling

- In a second round of appeal, the Income-tax Appellate Tribunal (Tribunal), agreeing with the findings of the ITSC, also held the trust to be a 'specific trust' due to the failure on the part of the Maharaja to appoint discretion exercisers.

- The High Court (HC) did not agree with the Tribunal's view, noting the following distinguishing features, namely (i) the taxpayer had not admitted to having received the income, (ii) the taxpayer had not received the said income, (iii) the taxpayer had not shown it as taxable income in the returns for all the years under appeal, and (iv) the income had been retained in the trust and not been disbursed to the beneficiaries.
- Applying Snell's Principle of Equity, the HC held that a discretionary trust was one which gave a beneficiary no right to any part of the income of the trust property, but vested in the trustees a discretionary power to pay him, or apply for his benefit, such part of the income as they thought fit.
- Merely because the settlor, and after his death, his son (the taxpayer) did not exercise their power to appoint the discretion exercisers, the character of the subject trust does not get altered.
- The SC, agreeing with the HC's view, held that the trust continued to be a discretionary trust.
- Therefore, the SC concluded that the income/ wealth of the trust could not be assessed in the taxpayer's hands until the time the discretion to distribute had been exercised by the trustees.

PwC observations

The case highlights the point that the income of a discretionary trust shall not be taxable in the hands of a beneficiary until distributed.

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