Corporate Professionals

SUCCESSION PLANNING THROUGH TRUSTS

Introduction

- **Family Businesses are the backbone of the Indian Economy, contributing over 75% to India's GDP.**
- **Most of Business families face unique management challenges because of the differences in the attitude & aspirations of family members.**
- **It has been observed that just 13% of the Family business survive till 3rd generation & only 4% go beyond the third generation and one-third of business families disintegrate because of generational conflict.**
- **It is always in the minds of entrepreneurs to extend the life span of family businesses.**
- **The creation of "Private Trusts" is one of the most common structures of Successional Planning for Family Businesses.**

Family

Oldest social institution in the history of mankind, that has survived through the ages.

Family Business: Strengths

- SHARED VALUES & VISION
- STABILITY
- COMMITMENT
- INNOVATION
- FLEXIBILITY
- LONG TERM OUTLOOK
- DECREASED COST

Landscape of Family Business in India

- Over 70% of businesses in India are Family businesses
- About 60% of the top 500 companies in India are family-controlled.
- India's top 10 family businesses have a combined value of ₹60 lakh crore.
- India's family-owned biz projected to drive 85% of GDP by 2047.

Note: Dominance of Family Businesses in nations like China, U.S.A. reflect upon its strategic advantages.

Survival Statistics

Contribution to global GDP

70%

Family businesses contribute 70% to the global GDP.

Transition rate to the second generation

30%

Only 30% of family businesses transition to the second generation.

Operate at the fourth-generation level and beyond

3%

A mere 3% of family businesses operate at the fourth-generation level and beyond.

Prominent Family Businesses: India

- RELIANCE GROUP
- ADITYA BIRLA GROUP
- TATA GROUP
- GODREJ
- JINDAL GROUP

Prominent Family Businesses: Internationally

- WALMART
- SAMSUNG
- TOYOTA
- MARS

Prominent Conflicts in Family Businesses

- Reliance Group
- Singhania Group – Raymond
- Bajaj Group
- Modi Group
- Ranbaxy

Need for Succession Planning

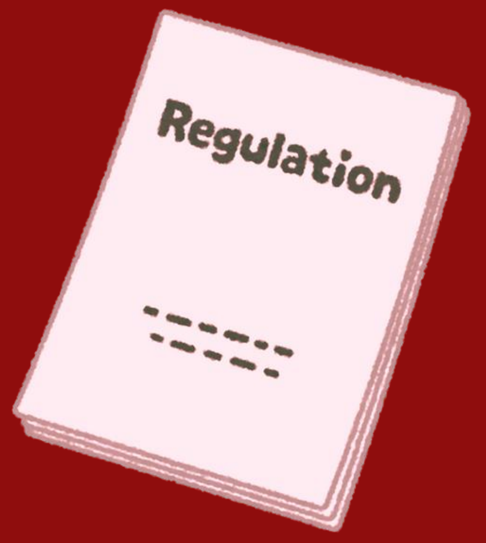
- For advancing the continuity of Family Business
- For Better Governance
- For Protection of Family Peace, Legacy and Prosperity
- For channelization of Conflicts into Valuable Asset

Regulatory Framework Governing Succession Planning

- TAX LAW [Capital Gains & Deemed Income]
- STAMP DUTY LAWS
- PARTNERSHIP LAW
- TRUSTS LAW
- COMPANY LAW

Regulatory Framework Governing Succession Planning

- SECURITIES LAWS
- SECTORAL LAWS
- PROPERTY AND REGISTRATION LAWS
- PERSONAL LAWS
- IPR LAWS



Indian Trusts Act, 1882

- **What is a Trust**
  - A trust is a legal arrangement involving the ownership and management of various assets.
  - It arises out of a confidence reposed in and accepted by the owner of the property or declared and accepted by him for the benefit of another and/or himself.

- **Parties involved in a Trust:**
  - **Author/Settlor/Trustor:** The person who reposes or declares confidence in another person for the creation of a Trust.
  - **Trustee:** The person who accepts the confidence for the creation of the Trust.
  - **Beneficiary:** The person for whose benefit the confidence is accepted.

  Note:
  - There may be more than one Settlors, Trustee/Beneficiaries.
  - Trustee is the legal owner and beneficiaries are the beneficial owner of the trust property.
  - Same person can be in any 2 of the above 3 roles in a Trust Structure

Objective of setting up of Trust

- **Protection of Assets:**

- In the event of a bankruptcy, a Trust can safeguard assets against creditor claims if the assets were transferred prior to bankruptcy being filed through an irrevocable and discretionary trust.
- Assets held in a family trust may have a better chance of being excluded from a property settlement than assets owned directly by an individual in the case of a family settlement.
- Placing assets in a Family Trust can help avoid ‘Will’ contests by ensuring that assets kept in the trust are not included in a deceased person’s estate.

Objective of setting up of Trust

- **Autonomous and Accurate Control:**

- The Settlor and the Trustee, both have a specific function to perform in managing the Trust.
- The primary objective of a trust is to empower the trustee with managing authority for the benefit of the beneficiaries. After signing the Trust Deed, the settlor must refrain from interfering, as each party’s roles and responsibilities are defined by the Trust Deed and the relevant law.

- **Preservation of Family Wealth :**

- Trusts can be created to possess specific assets that would be inappropriate or impractical for a Settlor to split between individuals, such as property or a stake in a family business. The use of a trust allows these individuals to benefit from the assets even though they do not own them. A trust will also aid in the preservation of such assets’ capital value for future generations.

Benefits of Private Trust

Protection of Family Interests	Efficient Management of Family Assets	Minimizing Disputes
Centralized Control of Family Business	Probate-Free Transition	Protection Against Insolvency Risks
Customizable Terms	Flexibility of Structure	Privacy

Formation of Trust

A trust may be created by any person who is competent to contract.

- Created for any lawful purpose.
- Author/Settlor and Trustee required to execute an 'instrument of trust' i.e., a Trust Deed.
- A formal written documents is not necessary for creating a trust – [**Radha Soami Satsung v. CIT, (1992) 193 ITR 321 (SC)]**. However, it is advisable to create trust through a written trust deed.
- Trust may also be declared by a Will of the Author.

Type of Trust

01 Specific Trust

02 Discretionary Trust

03 Irrevocable Trust

04 Deemed Revocable

05 Testamentary Trusts

06 Other Trusts

Type of Trust

- **Revocable Trust:** The Settlor/Author after the formation of the Trust may retransfer to himself any part of income or assets so transferred.

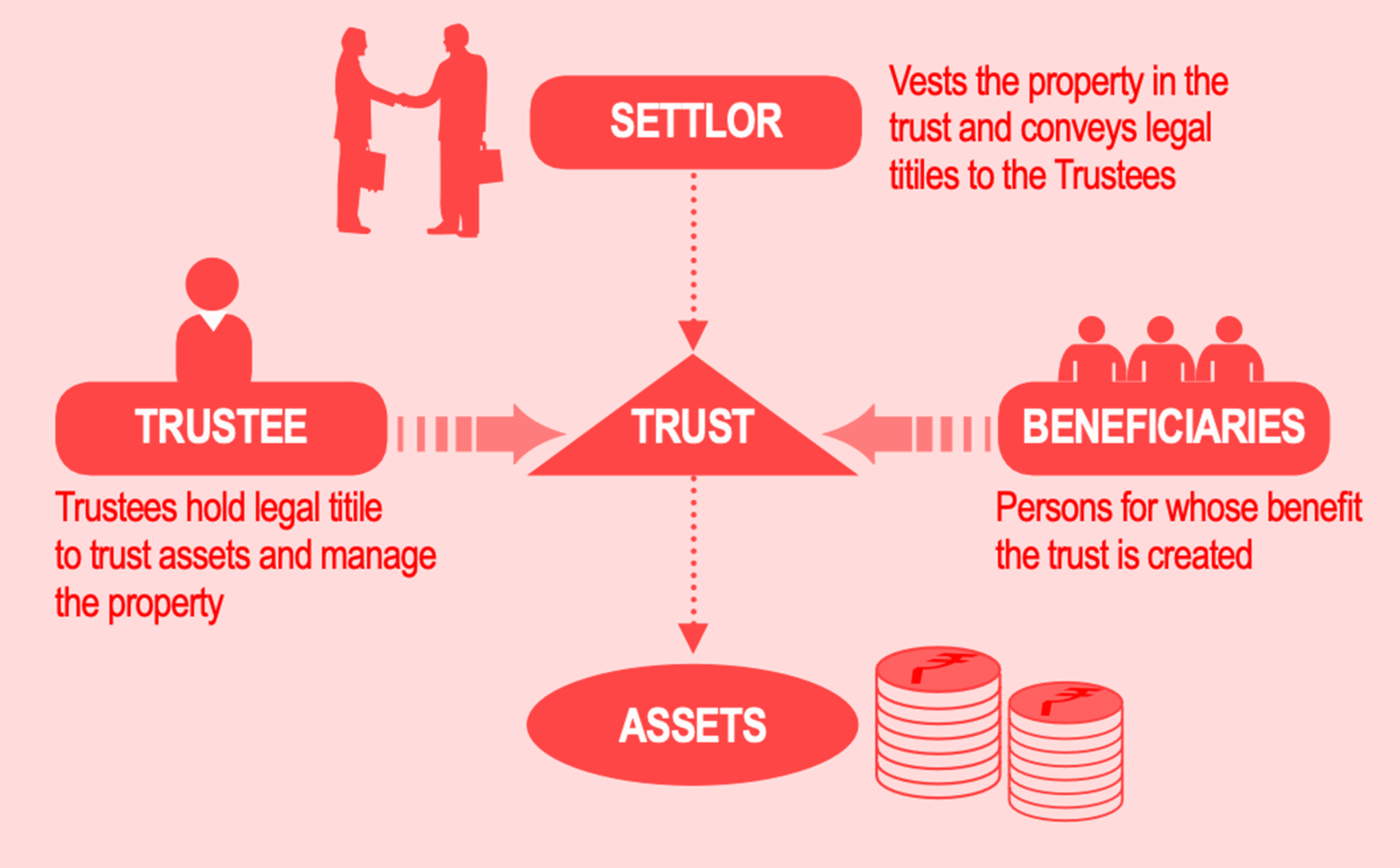
- **Irrevocable Trust:** Properties and assets of the Settlor/Author are completely and permanently transferred to the Trust.

- **Testamentary Trust:** Settlor/Author creates a Private Trust under a Will. The Trust in this case arises after the demise of the Settlor/Author.

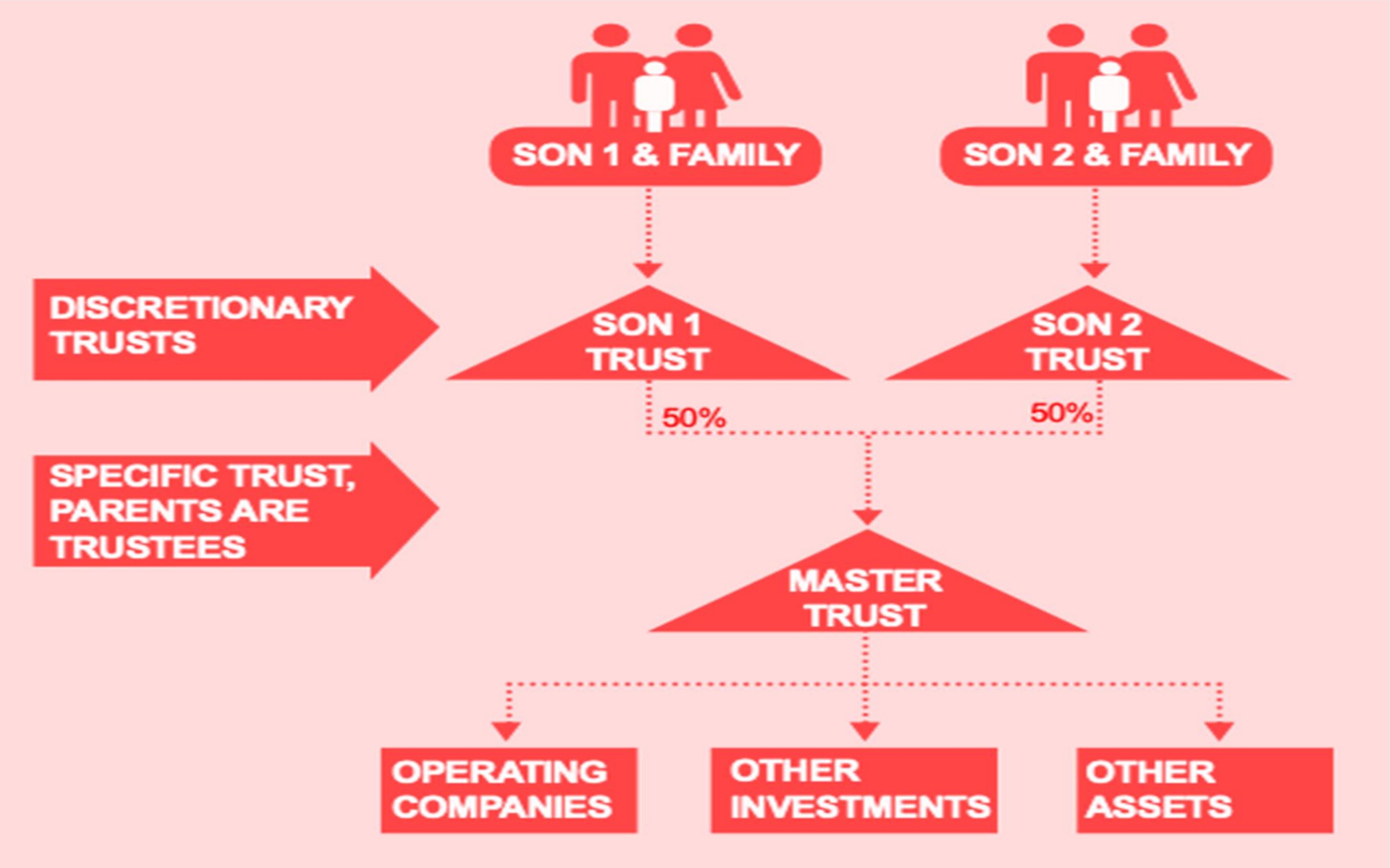
Steps for implementation of Trust

1. Settlor contributes assets to a Private Trust. Settlor can be a family head, e.g., Father
2. Settlor appoints a Trustee
3. Trust Deed specifies beneficiaries and % share (Specific or Discretionary Trust)
4. Trustee owns and manages assets for beneficiaries
5. Assets can be cash, movable, or immovable
6. Single or Multiple Trusts depending on needs
7. Master Trusts and Sub-Trusts for legal protection
8. Different Trustees and Beneficiaries for Master and Sub-Trusts
9. Execution of Trust Deed under applicable laws

A Simple Structure Of Trust



A Complex Trust Structure



Registration of Private Trusts

Immovable Property:

- Mandatory Registration: Trusts involving immovable property must be registered under law.
- Exception: If the trust is created under a will, registration is not mandatory.
- Purpose: Ensures legal ownership is recognized and safeguards against disputes.

Movable Property:

- Registration is not mandatory for movable property transferred to a trust.
- Movable property includes cash, investments, or other personal assets.

Documents Required for Registration:

- Trust Deed (core legal document outlining the terms and objectives).
- Identity and address proof of Settlor, Trustee(s), and Witnesses.
- Details of the property being transferred to the trust.

Procedure:

- Draft a trust deed specifying terms and beneficiaries.
- Submit the trust deed for registration at the Sub-Registrar's office.
- Pay applicable registration charges.

Stamp Duty on Private Trusts

When is Stamp Duty Applicable?

- Stamp duty is mandatory when property is transferred to a trust during the settlor's lifetime.
- Applies to both movable and immovable property.
- Exemptions: No stamp duty is required if the property is transferred to the trust under a will.

Amount of Stamp Duty:

- Varies depending on the jurisdiction and the nature of the property.
- Calculated based on the value of the property being transferred.

Payment Process:

- Stamp duty is paid to the local revenue department or via authorised banks.
- A receipt is issued, which must be attached to the trust deed.

Taxation of Private Trust

Taxation Aspects

TAXABILITY

Private Trust

Sec. 61

Revocable Trust
Trust Deed contains provision for retransfer of income/ assets to the Settlor/ transferor

Income Taxable in the hands of Settlor/Transferor

Sec. 160 - 166

Irrevocable Trust
Income taxable in the hands of the trustee in representative capacity of the beneficiaries

Sec. 160(1)(iv)

Business Income
[Sec. 161(1A)]

Taxable at MMR
[Explanation to Sec. 161]

Sec. 164 (1)

If, Trust is indeterminate i.e., share of beneficiaries are unknown as on date of trust deed

Other Income
Sec. 161(1)

Trust is determinate i.e., share of beneficiaries are unknown as on date of trust deed
[Sec. 161(1)]

Income taxable in the hands of the trustee in the same manner and to the same extent as that of the beneficiary

Taxability – Private Irrevocable Trust

- **Trustee as a Representative Assessee**
  - Trustees appointed under a trust declared by a duly executed instrument in writing whether testamentary or otherwise considered as “Representative Assessee”.
  - Trustees appointed under an oral trust are considered as “Representative Assessee”.
  - Trustees to represent the beneficiaries of the trust for whose behalf the income is received

Taxability – Private Irrevocable Trust

- **Liability of the Representative Assessee (Trustee)**
  - Having the same duties, responsibilities, and liabilities as if the income were income received by or accruing to or in favor of him beneficially
  - Liable to assessment in his own name in respect of that income in the representative capacity”
  - Recovery of tax from the trustee in like manner and to the same extent as it would be leviable upon and recoverable from the beneficiary

Taxability – Private Irrevocable Trust

- The assessment of the Trustee would have to be made in the like manner and same extent as that of the beneficiary. – [*CWT v. Trustees of H. E. H. Nizam's Family (Remainder Wealth) Trust; (1977) 108 ITR 555 (SC)*]

- **Taxability in the hands of the Trustee at "Maximum Marginal Rate" (MMR):**
  - Where the income represented by the trustee consists of or includes, profits and gains of business
  - Where the income is not specifically receivable on behalf or for the benefit of any one person
  - Where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate

Taxability – Private Irrevocable Trust

- **Residential Status of the Trustee**
  - Same status as the beneficiaries
  - If all are residents, the trustees would be treated as a resident and vice versa
  - where some of the beneficiaries are residents and some are not, as a general practice, the residential status of the trustees would be considered

- **Taxability on the transfer of assets by Settlor to a Trust**
  - Exempt in the hands of the Settlor as per section 47(iii) of the Income Tax Act
  - Recipient i.e., the trustee will get the cost of acquisition of the previous owner i.e., the Settlor

Taxability – Private Irrevocable Trust

- **Applicability of Section 56(2)(x) of the Income Tax Act, 1961 in the hands of the Trustee**
  - On transfer of asset by Settlor to a Trustee, same shall not be taxable in the hands of the Trustee
  - when the Trustee is receiving the property, there is an obligation accepted by the Trustee and acceptance of such obligation would be an adequate consideration for the receipt of property

Judgment of SC on applicability of Section 56(2)(x) of the Income Tax Act, 1961 in the hands of the Trustee

- As per section 3 of the Indian Trust Act, 1882, the "beneficial interest" or "interest" of the beneficiary is his right against the trustee as owner of the trust-property
- The said expression has been interpreted by the Supreme Court in case of **W.O. Holdsworth v. The State of Uttar Pradesh –**
  - "The trustee is thus the legal owner of the trust property and the property vests in him as such.
  - The expression "for the benefit of" and "on behalf of" are not synonymous with each other.
  - The rights which the beneficiary get is a limited one and such right in the property is not covered within the definition of term property as covered by section 56(2)(x).

Judicial Precedents

- **Moti Trust Kota vs. Commr. of Income Tax, Jaipur; (1999) 236 ITR 37 (SC)** - Even if a trust is regarded as Discretionary Trust, it is the beneficiary in whose hands the income will be assessed.

- **C.R. Nagappa vs. Commissioner of Income Tax; AIR 1969 SC 888**
  - Commissioner directed that the income for the deferred benefit of minor shall be included in total income of the Assessee Trustee.
  - The Apex Court, observed that assessment of minor was illegal, but it would not operate as a bar for application of Section 64(v).

  Held: Assessments against minor will be annulled but income of the Assessee i.e., Trustee was rightly computed.

Judicial Precedents

- **Buckeye Trust, Karnataka vs. Principal Commissioner of Income Tax ; ITA 1051/BANG/2024**

- The Tribunal agreed with the PCIT, stating that the trust was not solely for relatives and thus income received should be taxed under section 56(2)(x).
- It highlighted that significant amounts received by the trust were indeed without consideration, contradicting the appellant's claims.

This ruling emphasizes critical interpretations of tax law regarding trusts and beneficiary definitions, impacting how similar trusts may be assessed in the future.

Implication under other laws

- **The Companies Act, 2013**
  - In case the Trust is a Significant Beneficial Owner, then the trustee/beneficiaries/settlor, as the case may be, shall have to make appropriate disclosures to the company which in turn will make such disclosures to the Registrar of Companies
- **SEBI (SAST) Regulations, 2011**
  - Prior approval of SEBI is required.
  - Approval of SEBI needed to seek exemption under Regulation 11 of the Takeover Code from making an open offer.
- **FEMA**
  - Where beneficiaries/trustees are not residents in India, then prior approval of the Reserve Bank of India might have to be obtained.

TRUST AS PROMOTER IN LISTED COMPANIES

Triggering of Open Offer

Initial Trigger of 25% – Regulation 3(1)

Initial Trigger is at the acquisition of 25% or more of the voting rights in the Target Company

Shares already held by the Acquirer and PAC shall also be considered for calculation of 25% limit

Creeping Acquisition of 5% – Regulation 3(2)

Acquirer along with PAC already holds 25% or more of the voting rights but less than 75% of the voting rights

+

And if acquires additional 5% or more voting rights in any financial year

Creeping Acquisition can be done only upto the limit of 75% of the voting rights of the Company

Regulation 3(3)

Initial Trigger and Creeping Acquisition Trigger shall be checked on **individual** as well as **aggregate basis**

Acquisition of Control – Regulation 4

Right to appoint majority of the Directors

Right to control the management

Right to control policy decisions

Either directly or indirectly by virtue of their **shareholding** or **management rights** or **shareholders agreements** or **voting agreements** or **in any other manner**, etc.

Automatic Exemptions from Open Offer

Inter-se Transfer amongst Qualifying persons

Inter-se transfer amongst Qualifying Persons

- Immediate relatives
- Promoters for last 3 years as per shareholding pattern
- Group Companies

and certain other categories

Inter-se Transfer amongst Qualifying persons

WHY A PRIVATE TRUST IS NOT EXEMPTED UNDER THE REGULATION 10(1)(a)(i)

IMMEDIATE RELATIVE

‘immediate relative means any spouse of a person, and includes parent, brother, sister or child of such person or of the spouse’

Thus, Trust cannot be immediate relative as per the definition

Inter-se Transfer amongst Qualifying persons

WHY A PRIVATE TRUST IS NOT EXEMPTED UNDER THE REGULATION 10(1)(a)(i)

DISCLOSED AS ‘PROMOTER’ IN SHAREHOLDING PATTERN

‘Definition of Promoter under Takeover Regulations
“promoter” has the same meaning as in the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 and includes a member of the promoter group

Definition of Promoter under ICDR Regulations
“promoter” shall include a person:

1. *who has been named as such in a draft offer document or offer document or is identified by the issuer in the annual return referred to in section 92 of the Companies Act, 2013; or*
2. *who has control over the affairs of the issuer, directly or indirectly whether as a shareholder, director or otherwise; or*
3. *in accordance with whose advice, directions or instructions the board of directors of the issuer is accustomed to act*

Inter-se Transfer amongst Qualifying persons

WHY A PRIVATE TRUST IS NOT EXEMPTED UNDER THE REGULATION 10(1)(a)(i)

DISCLOSED AS 'PROMOTER' IN SHAREHOLDING PATTERN

Definition of Promoter Group under ICDR Regulations

(pp) "promoter group" includes:

i) the promoter;

ii) an immediate relative of the promoter (i.e. any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and

iii) in case promoter is a body corporate:

A) a subsidiary or holding company of such body corporate;

B) any body corporate in which the promoter holds twenty per cent. or more of the equity share capital; and/or any body corporate which holds twenty per cent. or more of the equity share capital of the promoter;

iv) in case the promoter is an individual:

A) any body corporate in which twenty per cent. or more of the equity share capital is held by the promoter or an immediate relative of the promoter or a firm or Hindu Undivided Family in which the promoter or any one or more of their relative is a member;

B) any body corporate in which a body corporate as provided in (A) above holds twenty per cent. or more, of the equity share capital; and

C) any Hindu Undivided Family or firm in which the aggregate share of the promoter and their relatives is equal to or more than twenty per cent. of the total capital;

Inter-se Transfer amongst Qualifying persons

WHY A PRIVATE TRUST IS NOT EXEMPTED UNDER THE REGULATION 10(1)(a)(i)

DISCLOSED AS ‘PROMOTER’ IN SHAREHOLDING PATTERN

<u>Thus, Trust cannot be inducted as member of Promoter and Promoter group automatically upon acquisition of shares</u>

Inter-se Transfer amongst Qualifying persons

WHY A PRIVATE TRUST IS NOT EXEMPTED UNDER THE REGULATION 10(1)(a)(i)

INTER-SE AMONGST GROUP COMPANIES

‘a company, its subsidiaries, its holding company, other subsidiaries of such holding company, persons holding not less than fifty per cent of the equity shares of such company, other companies in which such persons hold not less than fifty per cent of the equity shares, and their subsidiaries subject to control over such qualifying persons being exclusively held by the same persons;
Explanation: For the purpose of this sub-clause, the company shall include a body corporate, whether Indian or foreign.

Thus, Trust cannot claim exemption under this Regulation

Inter-se Transfer amongst Qualifying persons

Trust is not covered under qualifying persons defined in Regulation 10

AND

Trust is not defined in the definition of Promoter or Promoter group under ICDR

Thus, for the acquisition of shares by a Private Trust or for inducting a Private Trust as member of Promoter and Promoter group, no automatic exemption is available under Takeover Regulations

Exemption Application under Regulation 11

Conditions for seeking Exemption in case of Trust

- The Trust is in substance, should only be a mirror image of the promoters' holdings and consequently, there shall be no change of ownership or control of the shares or voting rights in the target company

- Only individual promoters or their immediate relatives or lineal descendants should be Trustees and beneficiaries

- The beneficial interest of the beneficiaries of the trust shall not be transferred, assigned or encumbered in any manner including by way of pledge/mortgage in future

- In case of dissolution of the Trust, the assets shall be distributed only to the beneficiaries of the trust or to their legal heirs

- The Trustees shall not be entitled to transfer or delegate any of their powers to any person other than one or more of themselves

Undertakings required to seek Exemption in case of Trust

- Change in trustees / beneficiaries and any change in ownership or control of shares or voting rights held by Trust shall be disclosed within 2 days to the stock exchanges and SEBI

- The ownership or control of shares or voting rights will be treated as vesting not only with the Trustees but also indirectly with the beneficiaries

- The liabilities and obligations of individual transferors will not change or get diluted due to transfers to the Trust

- The Trust shall confirm, on an annual basis, that it is in compliance with the exemption order passed by SEBI. The said confirmation shall be furnished to the company, which shall be disclosed prominently as a note to the shareholding pattern filed under LODR

- The Trust shall get its compliance status certified from an independent auditor annually and furnish the certificate to the Stock Exchanges and SEBI

Other Conditions for seeking Exemption in case of Trust

- The proposed acquisition is in accordance with the provisions of the Companies Act, 2013 and other applicable laws

- The transferors are disclosed as promoters in the shareholding pattern filed with the Stock Exchanges for a period of at least 3 years prior to transfer (except for holding on account of inheritance)

- There is no layering in terms of trustees / beneficiaries in case of Trusts

- The Trust deed agreement does not contain any limitation of liability of the trustees / beneficiaries in relation to the provisions of the SEBI Act and all regulations framed thereunder

Exemptions Granted

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THANK YOU