

**Western India Regional Council –
Pune Branch**

**Tax Issues Relating to Succession Planning &
Family Arrangements**

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May 27, 2017

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WILLS

TAX EFFECTS

- ❑ Whether transfer of a capital asset under a “Will” is a taxable transfer liable to capital gains tax?
 - No, transmission of a capital asset under a will is not regarded as a “transfer” u/s. 47(iii) of the Income-tax Act, 1961 (“the Act”)

- ❑ Whether any sum/gift received by an individual under a Will is chargeable to tax?
 - Inheritance is not “income” in general terms
 - No, section 56(2)(v)(c) of the Act, specifically excludes any sum received under a Will

- ❑ Sum received by the taxpayer from legal heirs in consideration of taxpayer giving up his right to contest the will of the deceased. As per the definition of “consideration” under Contract Act, taxpayer’s abstinence from contesting the will constituted consideration for payment. Thus, that sum received was not chargeable to tax under s. 56(2)(vii)
 - *Purvez A. Poonawalla v. ITO* [2011] 138 TTJ 673 (Mumbai)

TAX EFFECTS (contd...)

- ❑ “Right to sue” is not regarded as a capital asset- since not capable of being transferred
 - Baroda Cement & Chemicals Ltd. v. CIT (Guj) (HC) (158 ITR 636)
 - CIT v J Dalmia [1985] 20 Taxman 86 (Delhi)
 - Patel Brass Woks v CIT [2007] 163 TAXMAN 279 (GUJ.)
- ❑ Whether the expenses incurred on obtaining probate or other expenses in relation to the same are allowable expenditure under the Act?
 - No, they are not allowable
 - P.C. Mullick v. CIT [6 ITR 206 (PC)] and V. Ramaswamy Ayyangae v. CIT [11 ITR 597 (Mad. HC)]
- ❑ Even if the Executor is the sole beneficiary, it does not necessarily follow that he receives the income in latter capacity. The executor retains his dual capacity and hence, he must be assessed as an Executor
 - CIT v. Bakshi Sampuran Singh (133 ITR 650)



NOMINATION

POWER TO NOMINATE

□ Section 72 of the Companies Act, 2013* -

- Every holder of securities of a company may, at any time, nominate any person to whom his securities shall vest in the event of his death
- Joint holder of the securities - May nominate together any person to whom all the rights in the securities shall vest in the event of death of all the joint holders
- Notwithstanding anything contained in any other law for the time being in force or in any disposition, whether testamentary or otherwise, in respect of the securities of a company:
 - Where a nomination made in the prescribed manner purports to confer on any person the right to vest the securities of the company, the nominee shall, on the death of the holder of securities or on the death of the joint holders, become entitled to all the rights in the securities, of the holder or all the joint holders, in relation to such securities, to the exclusion of all other persons, unless the nomination is varied or cancelled in the prescribed manner

All rights in securities vested in nominee on death of shareholder

* Corresponding to section 109A of the Companies Act, 1956

NOMINATION V/S TESTAMENTARY SUCCESSION (contd...)

Sr. No	Case laws	Relevant Act	Held
Rights of heirs override rights of nominees			
1.	Smt. Sarbati Devi and Another v. Smt. Usha Devi [1983-(SC2)-GJX-0392-SC]	The Insurance Act, 1938	<ul style="list-style-type: none"> ▪ Mere nomination u/s. 39 does not deprive the heirs of their rights in the amount payable under a life insurance policy ▪ Nomination only indicates the hand which is authorised to receive the amount, on the payment of which the insurer gets a valid discharge of its liability under the policy ▪ The heirs of the assured can claim the amount in accordance with the law of succession governing them
2.	Vishin N. Khanchandani and Another v. Vidya Lachmandas Khanchandani and Another [2000-(SC4)-GJX-0458-SC]	The Government Savings Certificates Act, 1956	<ul style="list-style-type: none"> ▪ Though the nominee of the national savings certificates has a right to be paid the sum due on such savings certificates after the death of the holder u/s. 6, yet he retains the said amount for the benefit of the persons who are entitled to it under the succession law subject to the exception of deductions ▪ Follows the decision of Sarbati's case (<i>supra</i>)

NOMINATION V/S TESTAMENTARY SUCCESSION (contd...)

Sr. No	Case laws	Relevant Act	Held
Rights of heirs override rights of nominees			
3.	Shipra Sengupta v. Mridul Sengupta & Others [2009-(SC1)-GJX-1231-SC]	The Imperial Bank Of India Employees' Provident Fund Rules	<ul style="list-style-type: none"> ▪ Amount in any head can be received by the nominee, but the amount can be claimed by the heirs of the deceased in accordance with law of succession governing them ▪ In other words, nomination does not confer any beneficial interest on the nominee
4.	Salgaonkar-Ghatalia judgment (Suit No. 457 of 2014) (Bom)	The Companies Act, 1956	<ul style="list-style-type: none"> ▪ Rights in shares, debentures would pass on death of holder to nominee of such shares or to legal heirs of deceased ▪ Rights of heirs override those of a nominee ▪ A nominee is only a convenience to enable the company or bank or insurance company to discharge its obligation ▪ However, the nominee can only hold the proceeds as a trustee for the rightful heirs of the deceased whether under intestate law or under a valid Will

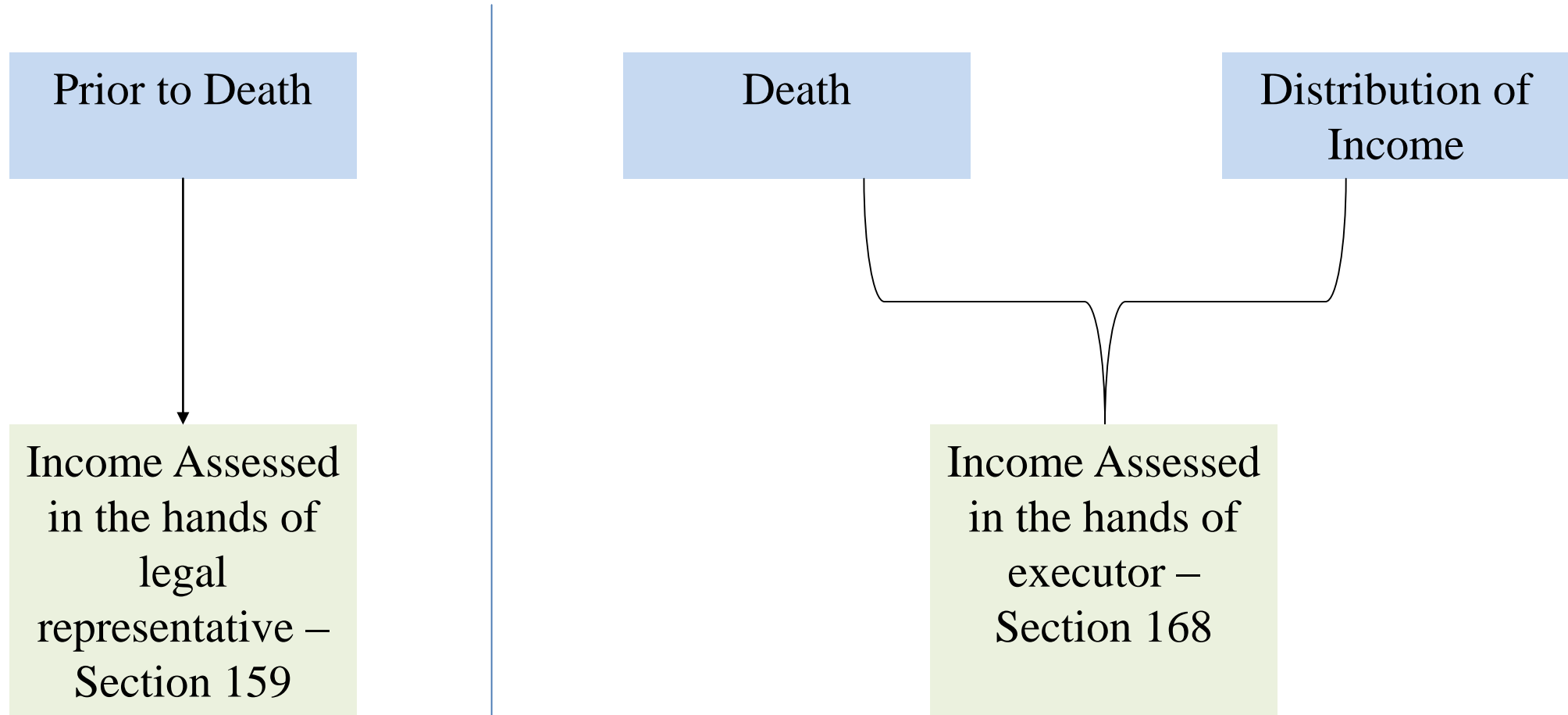
NOMINATION V/S TESTAMENTARY SUCCESSION (contd...)

Sr. No	Case laws	Relevant Act	Held
Rights of nominees override rights of heirs			
5.	Harsha Nitin Kokate v. The Saraswat Co-op Bank Ltd. & Ors [2010-(BO1)-GJX-1553-BOM]	The Depositories Act, 1996 read with the Companies Act, 1956	<ul style="list-style-type: none"> ▪ A reading of s. 109A of the Companies Act and 9.11 of the Depositories Act makes it abundantly clear - Intent of the nomination is to vest the property in the shares which includes the ownership rights thereunder in the nominee upon nomination validly made ▪ These Sections are completely different from : <ul style="list-style-type: none"> • s. 39 of the Insurance Act which require a nomination merely for the payment of the amount under the Life Insurance Policy without confirming any ownership rights in the nominee or • s. 30 of the Maharashtra Cooperative Societies Act which allows the Society to transfer the shares of the member which would be valid against any demand made by any other person upon the Society ▪ Since the nomination is shown to be correctly made by the holder of the Suit shares, the heir would have no right to get the shares of her deceased husband sold or to otherwise deal with the same



**RETURNS OF DECEASED
AND
EXECUTORS OF ESTATE**

ASSESSMENT u/s. 159 AND 168



SECTION 159 (contd...)

- ❑ An assessment cannot be made on a dead person and, if so made, would amount to nullity
 - Ellis C Reid v CIT [5 ITC 100 (Bom)]
 - CIT v Amarchand N Shroff [48 ITR 59 (SC)]

- ❑ Name of the representative and his capacity must be specified in order of assessment, otherwise assessment is void

- ❑ Notice issued to the legal representative should clearly mention that it is served upon him in his capacity as a legal representative of the deceased and that the assessment proposed is that of the income of that deceased

SECTION 159 (contd...)

- ❑ On service of notice, the legal representative becomes the assessee for all purposes under the Act, including recovery and penalty proceedings
 - ITO (Addl) v Alfred (E) [44 ITR 442 (SC)]
 - ITO (First Addl) v Abdul Kassim (TMK) [46 ITR 149 (SC)]

- ❑ Legal representative would not continue to be assessed indefinitely as if the deceased assessee has not died at all

- ❑ The liability of the legal representative is limited to the estate of the deceased which has come into his possession, if any, and is not personal
 - Union of India v Sarojini Rajah (Mrs) [97 ITR 37 (Mad.)]

SECTION 159 (contd...)

- ❑ Arrears of tax of deceased cannot be adjusted against refund due to the legal representative in his individual capacity
 - Hasmukhlal v ITO [251 ITR 511 (MP HC)]

SECTION 168 (contd...)

❑ CIT v. Dhanalakshmi [215 ITR 662 (Mad)]

- Not applicable to a case when succession is an intestate succession

❑ CIT v. Ghosh (Mrs A) [159 ITR 124 (Cal)]

- Legal heirs are assessable only after distribution. Executors would be assessed till distribution
- Income prior to distribution is assessable in the hands of the executor alone, who is responsible for filing of return and payment of tax

❑ ITO v. Suseela Sadanandan (57 ITR 168)

- Capacity of the executor to represent estate derived under will does not depend on whether probate is obtained

SECTION 168 (contd...)

- ❑ CIT v. Seth (GBJ) [(1982) 133 ITR 192 (MP)]
 - Losses of earlier years carry forward in the hands of the deceased, can be set off against the income of the estate

- ❑ As long as the administration is incomplete, the executor or administrator is liable to be taxed at the rate applicable to the entire total income in his hands, irrespective of the claims of the various legatees

ISSUES

- Can be challenged in the Court of Law in case of production of multiple Wills
- Cannot be executed during the lifetime of the testator



FAMILY ARRANGEMENTS

WHAT CONSTITUTES A ‘FAMILY’

- ❑ Word “family” has been widely interpreted in the following decisions:
 - Ramgouda v. Bhausahab (AIR 1927 PC 227);
 - A. Hassan v. T. Hassan (AIR 1958 (Pat.) 232);
 - BibniBewa v. Padmanav Swain (AIR 1956 (Ori.) 105);
 - Mst. Ramu Bai v. Giyaram Sharma (AIR 1964 (Bom.) 96);
 - Shivmurtappa v. Fakrippa (AIR 1954 (Bom.) 430);
 - CGT v. Smt. GollapudiSanthamma (116 ITR 930) (AP.);
 - Pavitri v. Katheesumma (AIR 1959 (Ker.) 319)

WHAT CONSTITUTES A 'FAMILY'

(contd...)

- ❑ In view of the closeness of the relationship between the persons who were disputing the right over the property with one another, the arrangement between them was legal and enforceable
 - Ramgowda Annagowda Patil v. Bhausahab (AIR 1927 PC 227)
 - Mehdi Hasan v. Ram Ker (AIR 1982 All. 92)

- ❑ A party who takes benefit under a family settlement need not necessarily be shown to have, under the law, a share in the property and all that is necessary to show is that the parties are related to each other in some way and have a possible claim to the property or even a semblance of claim on some ground or other
 - Ramcharan Das v. GirijaNandini Devi (AIR 1966 SC 323)

NOT A TRANSFER u/s. 2(47)

- ❑ Transfer under Family Settlement – Not considered as a transfer u/s 2(47)
 - Every member has a pre-existing title to the property which is the subject matter of the transaction ;
 - Intention is to benefit the family by compromising on disputed rights by avoiding litigation;
 - Mere crystallization of the respective rights in family properties ;
 - Realignment of interest by way of effecting family arrangement among the family members ;
 - There is no chargeable capital gain arising from that transaction ;
 - Assumption underlying is that the parties have antecedent rights in the assets and the other parties accept such claim

NOT A TRANSFER u/s. 2(47) (contd...)

- ❑ Transfer under Family Settlement - Not considered as a transfer u/s 2(47)
 - ACIT v. Goyal Dresses [(2010) 126 ITD 131 (Chn (ITAT))];
 - CIT v. Kay Arr Enterprises [(2008) 299 ITR 348 (Mad HC)] [SC in 306 ITR 5 rejected SLP]
 - CIT v. R Ponnammal [(1986) 28 TAXMAN 26 (MAD HC)];
 - CGT v. D. Nagrirathinam [266 ITR 342 (Mad)];
 - Shirish S. Maniar v. ITO [(2008) 167 TAXMAN 81 (Mum ITAT)];
 - Commissioner of Gift Tax v. K.N. Madhusudan (Gift Tax Appeal Nos. 1&2/2008);
 - Mrs. Urmila Mahesh Nathai v. ITO (ITA No. : 5921/Mum/2012)

CHARGEABILITY UNDER THE GIFT TAX ACT

Sr. No	Case laws	Held
1.	Smt. A. Omera Parvez v. GTO [(1983) 3 ITD 250 (Mad)]	<ul style="list-style-type: none"><li data-bbox="1039 475 2440 692">▪ The transaction under a bona fide family settlement entered into by the parties who are members of a family to put an end to the dispute or potential dispute among themselves, is not a transfer for the purpose of Gift Tax Act<li data-bbox="1039 758 2023 803">▪ Family settlement itself is a valid consideration
2.	GTO v. Smt. Chinthamani Achi [(1983) 4 ITD 237]	
3.	GTO v. Bhupati Veerabhadra Rao [(1984) 9 ITD 618 (Hyd)]	

ISSUES

- ❑ Whether Cousin – of members of the same family , can be party to the Family Arrangement
 - *common tie of relationship is enough to bring a person within the fold of 'family'. Whenever there is legal claim by any person against near relations, then all such persons shall stand included within fold of a family. It is not necessary that the parties to the arrangement should all belong to one family. The Apex Court further held that the word "family" in the context of family arrangement is not to be understood in a narrow sense of being a group of persons who are recognized in law as having a right of succession or having a claim to share in the property in dispute.*

Krishna Biharilal & Gulabchand and others (AIR 1971 SC 1041)(SC)

- ❑ Receipts under Family arrangement- implications u/s 56(2) ?
- ❑ Receipt from HUF – implications u/s 56(2) ?
- ❑ Can a company be a party to family settlement ?
- ❑ Can a firm be a party to family settlement ?

ISSUES (contd...)

- ❑ Surrender of a portion of the properties bequeathed to the assessee by her father in favour of her minor son amounted to only a family arrangement and there was no transfer as under section 64(iii)
 - CIT v. R. Ponnammal [(1987) 164 ITR 706]

- ❑ Reconstitution of partnership firm pursuant to family settlement – not amount to dissolution of firm u/s 45(4)
 - CIT v. A.N. Naik Associates (265 ITR 346) (BOM)



TRUST

TYPES OF TRUSTS FOR TAX PURPOSES

- ❑ Specific Trusts v. Discretionary Trust;
- ❑ Revocable Trust and Irrevocable Trust

SPECIFIC TRUST

❑ Where trusts carries on business:

- Entire income of the Trust (not just the business income) is chargeable in the hands of the Representative Assessee (“RA”) at MMR
- Exemptions from this provision granted if all the following 3 conditions are satisfied:
 - Testamentary Trust;
 - It is for benefit of any dependent relative; and
 - It is the only trust declared by the testator

DISCRETIONARY TRUST

❑ Definition:

- Beneficiaries are not identified on the date of Trust Deed; or
- Shares of beneficiaries are not expressly stated in the Trust deed and are not ascertainable on the date of the Trust Deed

❑ RA chargeable on the total income of the trust at the MMR

❑ Exception: In following cases, tax shall be charged at the rate applicable to an AOP, if there is no business income

- No beneficiary has other chargeable income and no beneficiary is a beneficiary under any other trust;
- Testamentary trust which is the only trust declared under the will(exception even if there is business income);
- Trusts created pre 1970 for relatives of the settlor;
- PF/SF/GF Trusts

REVOCABLE TRUST

- ❑ Section 61 - income arising by virtue of revocable transfer of the assets- chargeable to income tax as the income of transferor

- ❑ Section 62 - if the trust settled is not revocable during the life time of the beneficiary, but revocable thereafter, then:
 - During the lifetime of the beneficiary: income taxed as per s.161 or 164 as applicable;
 - After the power to revoke arises: income taxed as income of the transferor

- ❑ Section 63 - transfer is deemed revocable by statutory fiction if:
 - There is a provision in the trust deed that part or whole of the income or assets will be re - transferred to the transferor- i.e. the Settlor/ transferor is also Beneficiary

TAXABILITY OF TRUST

- ❑ Taxed through a representative assessee, i.e. the trustee – section 160(1)(iv)
- ❑ Rate of tax and extent of taxation depends on the type of trust
- ❑ Revocable Trust:
 - Section 61 – taxable in the hands of the transferor
- ❑ Irrevocable Trust:
 - Taxable u/s. 161/164 depending upon whether it is determinate or indeterminate trust

TAXABILITY OF TRUST (contd...)

Determinate Trust

- Taxable u/s. 161;
- Tax liability co-extensive with that of the beneficiary;
- ‘in the like manner and to the same extent’ as the beneficiary, except in case of business income, which is taxed at MMR ;
- U/s. 166, AO has an option to tax beneficiaries instead of the trustee

Discretionary Trust

- Taxable u/s. 164 at MMR except:
- where none of the beneficiaries has any other chargeable income to tax and is a beneficiary under any other trust; or
- where the relevant income is receivable from the trust declared by any person by will and such trust is the only trust declared by him;
- where the relevant income is receivable by the trustee on behalf of a provident fund, etc.

STATUS OF TRUSTS (PERSON)

- ❑ Trust is assessed as an individual or an AOP?
 - Section 2(31) does not cover ‘trust’ specifically in the definition of ‘person’
 - Trustee is only a representative and his status follows that of the beneficiaries

- ❑ For an AOP, the persons need to come together for common purpose
 - CIT v. Shri Krishna Bandar Trust [201 ITR 989 (Cal)]
 - CIT Vs Marsons Beneficiary Trust [188 ITR 224 (Bom)]
 - Deepak Family Trust [211 ITR 575 (Guj)]
 - CWT v Trustees of H.E.H Nizams Family (Remainder of Family Trust) [(1977) 108 ITR 555 (SC)]

STATUS OF TRUSTS (PERSON) (contd...)

- ❑ Status of a trust is determined based on the status of the beneficiaries. In the following decisions, it has been held that a trust in which all beneficiaries are individuals is to be assessed as an individual:
 - Nizam's Family Trust, 108 ITR 555(SC)
 - LR Patel Family trust v. ITO, 262 ITR 520(Bom)
 - Marsons Beneficiary Trust, 188 ITR 224(Bom)
 - CIT v. S.A.E. Head Office Trust, 271 ITR 159(Del.)
 - DIT v. Shardaben Mafatlal Trust 247 ITR 1(Bom)

STATUS OF TRUSTS (RESIDENTIAL STATUS)

- ❑ Trusts where beneficiaries are Non-Resident :
 - Specific Trust
 - Discretionary Trust

TAXABILITY OF TRUSTS

❑ Taxability in the hands of beneficiary

- CIT v. Kamalini Khatau [209 ITR 101 (SC): where from out of the income of a discretionary Trust, beneficiaries receive something during the relevant year, such distribution is chargeable to tax in the hands of the beneficiaries
- CIT v. Dr. David Joseph (214 ITR 658): once the income is assessed in the hands of beneficiary it cannot be assessed in the hands of Trust and vice versa
- Circular No. 157 dated 26.12.1974: assessment can be made either on trustee or on beneficiary, not both

CAPITAL GAINS

Sec 47(iii)

Exempts transfer of an asset under “irrevocable trust”

Sec 48

Transfer under a “revocable trust”- no consideration-no capital gain

Sec 49

Go to cost to previous owner of revocable and irrevocable trusts

Sec 2(42a)

Consider the period of holding of the settlor/transferor (previous holder)

Indexation

Available to the trust from the date of holding by Settlor / transferor*

Revocable
Transfer

Capital gains so computed become taxable in the hands of transferor

*CIT vs Manjula J. Shah (355 ITR 474)(Bom)(HC) and Arun Shungloo Trust vs CIT(ITA No. 116/2011) (Del)(HC)

SECTION 56(2)(x)

Insertion of s. 56(2)(x) - by the Finance Act, 2017 (w.e.f. April 1, 2017)

❑ *Present provisions (applicable upto April 1, 2017):*

- Tax on property received for inadequate consideration was taxable only in the case of individuals and HUFs
- Further, in case of closely held companies and firms, shares of a closely held company received for inadequate consideration was taxable in the hands of the recipient

❑ *Proposed provisions :*

- The scope is widened to cover all types of assesseees in respect of all types of properties
- Accordingly, all types of assesseees, receiving any sum of money or any property (movable or immovable) for an inadequate consideration would be subject to tax, if the difference between the consideration and the fair market value of the property exceeds Rs. 50,000

SECTION 56(2)(x) (contd...)

Effect of change... :

Individuals and HUF's -

- No change

AOP and BOI -

- The scope of section widened to cover these assesseees

Firms and companies -

- Scope extended to all assets, which hitherto were applicable only in respect of shares of “closely-held companies”;
- Presently, an exemption was provided to a company in which public are substantially interest, which is proposed to be withdrawn. Further, any property received by even listed companies for inadequate consideration would be covered

**Draft rules prescribed for the purpose of valuation of shares u/s
56(2)(x)**

SECTION 56(2)(x) (contd...)

...Effect of change :

❑ Trusts -

- Section 56(2)(x) not to apply to any sum of money or property received, *inter alia*:
 - From / by any trust or institution registered u/s. 12A or 12AA
 - From an individual by a trust created or established solely for the benefit of relative of the individual

ISSUES (contd...)

- ❑ Receipts by a Trust or from a Trust :-
 - Specific exemption provided to charitable trusts/institutions ;
 - However, in case of Private Trusts – specifically exempted

- ❑ On distribution of Corpus to beneficiaries, in case the trust is a
 - Specific Trust or
 - Discretionary Trust

APPLICABILITY OF SECTION 56(2)

(contd...)

- ❑ When Settlor settles his assets in a family trust:
 - Trustee is receiving in a mere fiduciary capacity and not in his own rights;
 - Trustee is bound by obligation to carry out the directions of the Settlor. Hence, not without consideration

- ❑ When Trustees transfer the assets to the Beneficiary:
 - Beneficiary getting his rights under the trust. Legal view: Not without considerations

ISSUES (contd...)

- ❑ Discretionary trusts – set up for individual beneficiaries - taxable as individuals and hence, would be entitled to deduction/ benefits available to individual under the Act:
 - Deepak Family Trust [211 ITR 575 (Guj)];
 - Shardaben Mafatlal Trust [(247 ITR 1 (Bom)];
 - Venu Suresh Sanjay Trust [221 ITR 649 (Mad)];
 - Ramesh Mahesh Sanjay Trust [231 ITR 752 (Mad)]

Deduction u/s.
80L

- ❑ Taxability of long term capital gains @ 20%, at per the rate u/s 112 of the Act- even when income of discretionary trust taxable at MMR:
 - SAE Office Trust [271 ITR 159 (Del)]

- ❑ Whether a trust could become a beneficiary in another trust, having regard to the provisions of section 8 of the Indian Trust Act, 1882?

SECTION 56(2)(x) – DRAFT RULES

(contd...)

- ❑ CBDT issued draft rules (to come into force w.e.f April 1, 2018 vide Press Release dated May 5, 2017 for stakeholder's comment)
- ❑ Proposes to substitute Rule 11UA(1)(c)(b) and inserting Rule 11UAA to prescribe the method of valuation of unquoted equity share for the purpose of sections 56(2)(x) 50CA :
 - By taking into account the FMV of jewellery artistic work, shares and securities and stamp duty value in case of immovable property and book value for the rest of the assets

SECTION 56(2)(x) – DRAFT RULES

(contd...)

- ❑ Issues relevant for public debate/representation
 - Valuation in cases of cross holdings is not addressed in the draft rules
 - The proposed rules shall apply to all transactions on or after April 01, 2017. To that extent, the rules may have a retrospective effect
 - The proposed rules shall apply irrespective of the valuation methodology agreed upon in Shareholder's Agreement/ J.V. Agreement
 - The proposed rules may apply irrespective of lock-in-period under such Shareholder's Agreement/ J.V. Agreement where internal transfer to Affiliates is permitted

SECTION 115BBDA

❑ Introduction of s. 115BBDA - by the Finance Act, 2016 (w.e.f. April 1, 2017)

- If the total income of a resident individual / HUF / firm includes any income in aggregate exceeding Rs.10 lakh, by way of dividends declared, distributed or paid by a domestic company
 - The said excess income shall be chargeable to tax at the rate of 10% in the hands of such individual / HUF / firm

❑ Amendment in section 115BBDA – by the Finance Act, 2017 (w.e.f. April 1, 2018)

- Now, scope extends to all resident assessee except domestic companies and certain funds, trusts (12A/12AA registered trusts), institutions, etc.

Applicability to a trust ?

ISSUES

- ❑ Whether private trust receiving dividend is covered ?
 - Trust is assessed as an individual

- ❑ What would be the taxability in case of a specific trust where dividend income is greater than Rs. 10 lakhs and share of each beneficiary is less than Rs.10 lakhs ?



THANK YOU !