Dipen D Shah & Associates

CHARTERED ACCOUNTANTS

Private Trusts in India: Formation, Classification, Stamp Duty, Asset Transfers, and Dissolution — A Legal Overview

604, Block B,Addore Aspire 2,Opp.Old Passport office, University Road,
Nr.Jhanvi Restaurant, Gulbai Tekra, Ahmedabad 380009

1. Introduction

In India, the constitution of private trusts and the nature of property settled therein have evolved over time, and are commonly deployed as instruments for estate planning, succession structuring, and (where lawfully permissible) tax efficiency by families and other persons. For purposes of Indian law, Section 3 of the Indian Trusts Act, 1882 defines a "trust" as "an obligation annexed to the ownership of property, 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."

2. Private Trust: Meaning and Basic Understanding

2.1 Meaning

A private trust is a legal arrangement whereby the settlor transfers and/or settles identifiable property upon one or more trustees, to be held, managed, and applied for the benefit of identified beneficiaries (or a determinate class of beneficiaries), in accordance with the trust deed.

Such arrangement is ordinarily utilised to formalise family or succession arrangements and to ensure that trust property is administered and applied strictly in the manner contemplated by the settlor, subject to applicable law.

2.2 Key Benefits

- Protection and ring-fencing of family assets, including segregation from personal risks (subject to applicable law and creditor rights).
- Succession planning and structured distribution of income and/or corpus during the settlor's lifetime and/or upon occurrence of specified events.
- Continuity of management and administration in circumstances of incapacity, absence, or other contingencies affecting the settlor.
- Enhanced confidentiality in certain structures, including in scenarios where probate proceedings may be avoided, subject to the facts and applicable law.

2.3 Key Components of a Private Trust

Without prejudice to the specific terms of any instrument, a typical private trust arrangement comprises the following principal constituents:

- **Settlor / Author / Contributor:** The person who settles property upon the trust and conveys legal title therein to the trustee(s). The settlor must evince a clear and unequivocal intention to create a trust by segregating specific and identifiable property for the benefit of the beneficiary(ies). Such intention may be manifested by words and/or conduct (whether written or oral), but must not remain undisclosed.
- **Trustee(s):** The person(s) in whom legal title to the trust property vests, and who are obligated to administer the trust in accordance with the trust deed and applicable law. A trustee may be the settlor and/or any other competent person. The trust deed should clearly articulate the objects of the trust and the powers, duties, and limitations of the trustee(s).
- **Beneficiary(ies):** The person(s) for whose benefit the trust is constituted. In commercial and estate-planning contexts, beneficiary(ies) may, subject to law, include individuals and/or juristic entities (including companies, firms, and sub-trusts), and not merely natural persons.
- **Trust Property (Corpus / Assets):** Any movable and/or immovable property capable of being held in trust, including cash, bullion, securities, shares, houses, and land. The subject-matter of the trust must be definite and identifiable.
- **Instrument of Trust (Trust Deed):** The written instrument evidencing the terms upon which the trust is created and administered, including (without limitation) the objects, beneficiaries, dispositive provisions (income/corpus), trustee powers, governance, accounting, termination, and ancillary provisions. The trust deed constitutes the governing document of the trust.
- **Protector (if appointed):** Not mandatory under Indian law; however, where trustees are not family members, a protector may be appointed to supervise specified trustee actions and, where contractually provided, to remove/replace a trustee for cause, including misconduct or breach of trust.

3. Classification of Private Trusts

3.1 Overview

- Private trusts are commonly categorised, inter alia, by reference to (a) the discretion (or absence thereof) vested in the trustee(s) concerning distributions, and (b) the revocability of the underlying transfer for income-tax purposes.
- The principal classifications relevant for private family arrangements are outlined below.

3.2 Specific (Non-Discretionary) Trusts

- **Non-Discretionary/Specific Trusts:** In this type of trust, the settlor determines which beneficiary will receive which assets and in what proportion. The trustee has no discretion in distributing or paying out the trust assets. For example, the settlor may specify the share each child will receive.

3.3 Discretionary Trusts

- **Discretionary Trust:** In this type of trust, the settlor specifies only the class/list of beneficiaries, but does not fix their shares. The trustee decides the proportion of assets or income to be given to each beneficiary. As per Mozley & Whiteley's Law Dictionary, such trusts grant trustees absolute discretion over the application of trust assets. A well-drafted discretionary trust may also allow the trustee to include or exclude beneficiaries, providing flexibility to respond to changing circumstances. This type of trust is often suitable where beneficiaries are minors.

3.4 Revocable and Irrevocable Trusts

- **Revocable/Irrevocable Trusts:** This distinction is primarily relevant to the taxability of transfers to and from a private trust under the Income-tax Act, 1961. A revocable trust permits the transferor to reclaim the assets or income transferred to the trust under specified conditions. Under Section 61 of the Income-tax Act, 1961, income arising from a revocable transfer is taxable in the hands of the transferor and must be included in the transferor's total income. While revocable trusts generally do not provide tax benefits or creditor protection, they offer greater flexibility and control.
- **Irrevocable trust:** Once constituted, the settlor is not entitled to unilaterally modify or revoke the trust or re-assume the transferred property, save as may be expressly provided in the trust deed and permitted by law.
- **Income-tax treatment:** Income arising from an irrevocable transfer is generally not clubbed with the settlor's income, subject to the specific anti-avoidance and clubbing provisions under the Income-tax Act, 1961 and the terms of the instrument.
- **Commercial rationale:** Irrevocable structures are often preferred for long-term asset protection and succession objectives and may yield tax efficiencies where permissible.

3.5 Testamentary Trusts (Will Trusts)

- **Testamentary Trusts/Will Trusts:** A trust can be created through a will, allowing the testator (the person making the will) to ensure that their assets are managed and distributed according to their wishes after their demise. Such trusts are called testamentary trusts. As per the Indian Succession Act, 1925, a person of sound mind, who has attained the age of majority, may make a valid will in writing and in the presence of two attesting witnesses.

  A testamentary trust takes effect only on the death of the testator and generally does not require registration during the testator's lifetime. Since it does not operate during the settlor's lifetime, the testator remains free to alter the will at any time before death, either by a codicil or by executing a fresh will. After the testator's demise, the trust becomes irrevocable as per the last valid will.

  Testamentary trusts are widely used for estate planning, especially where beneficiaries are minors, persons with disabilities, or others who may not be in a position to manage substantial assets. The testator can appoint a trusted person as trustee to manage and apply the assets until the beneficiary attains the specified age or meets stated conditions. A key limitation is that, since the trust operates only after death, it does not provide immediate asset protection during the testator's lifetime.

3.6 Living Trusts

- **Living Trusts:** A living trust (also called an inter vivos trust—Latin for "between the living") is created during a person's lifetime to hold and manage assets. Unlike a testamentary trust, it operates while the settlor is alive and may be modified or revoked. Such a trust takes effect immediately.

3.7 Determinate and Identifiable Beneficiaries

It is important to note that, irrespective of the type of private trust, the beneficiaries should be determinate and identifiable. It is a well-established principle that a private trust created for unknown beneficiaries is void ab initio, and the property reverts to the settlor. The Supreme Court in Deoki Nandan v. Murlidhar, AIR 1957 SC 133, settled this principle when it observed: "In private trusts, the beneficial interest is vested absolutely in one or more individuals who are, or within certain time, may be definitely ascertained."

4. Private Family Trusts as a Means of Planning Succession

- A trust separates legal ownership from beneficial ownership; accordingly, control over an asset may vest with the trustee(s), while the economic benefit accrues to the beneficiary(ies), subject to the trust deed.
- Illustratively, a family head may settle shares of a family company, immovable property, and/or other assets into a trust and appoint self, spouse, and/or a trusted third party as trustee(s) for the benefit of family members (including minors).
- Beneficiary entitlements may comprise periodic income (e.g., dividends, rent) and/or corpus distributions, either during the trust term or upon termination, in each case strictly as provided in the trust deed.
- A private trust cannot be perpetual; the rule against perpetuity under Section 14 of the Transfer of Property Act, 1882 limits the duration/vesting of interests, and the instrument must be structured accordingly.
- Properly structured, private trusts may reduce succession disputes and may mitigate future exposure to estate-duty / inheritance-tax regimes, if introduced, particularly where assets have been irrevocably settled (subject to any future legislation).

5. Stamping of the Trust Deed

• A trust is ordinarily constituted by an instrument of trust (i.e., a trust deed) whereby the settlor declares and/or settles property upon the trust.
• A "declaration of trust" is treated as an instrument for stamp duty purposes under the Indian Stamp Act, 1899 (as applicable) and relevant state amendments.
• Stamp duty is payable on such declaration/instrument, typically at the time of execution, even prior to transfer of identified assets into the trust (subject to the applicable state stamp law).
• The applicable rates vary by state; duty on a bare declaration of trust is, in many jurisdictions, comparatively nominal.
• While "declaration of trust" is not expressly defined under the Stamp Act, "settlement" is defined in Section 2(24) of the Indian Stamp Act, 1899 to include (inter alia) a non-testamentary disposition in writing of movable or immovable property for distribution among family and allied purposes.
• The definition of "settlement" also extends to instruments recording—whether by way of declaration of trust or otherwise—the terms of such disposition.
• Accordingly, execution of a trust deed may raise a characterisation issue as to whether the instrument is merely a trust deed or constitutes a "settlement" attracting higher duty (often linked to the value of property settled), depending on the state law and the operative clauses.
In this context, the Supreme Court in S. N. Mathur v. Board of Revenue & Ors. considered the distinction between a "settlement" and a "trust deed", and observed, in substance, that:
• S. N. Mathur v. Board of Revenue & Ors.: The definition of "settlement" is of wide amplitude and may cover a declaration of trust where the instrument records a non-testamentary disposition for a stated purpose and the executant divests ownership in favour of the trust/trustee(s).
• Whether an instrument is treated as a declaration of trust or as a settlement is fact-specific and turns on the operative clauses and the extent of divestment of ownership.
• A relevant consideration is the underlying purpose of the disposition, including whether it is intended for distribution among family members and/or provision for dependants of the settlor.
• Given the narrow line between the two, stamp duty implications should be examined prior to execution, with reference to the applicable state stamp legislation and the proposed mode of asset transfer.

6. Transfer of Immovable Property to the Trust

• Validity requirement: Pursuant to Section 5 of the Indian Trusts Act, 1882, no trust in relation to immovable property is valid unless created by a non-testamentary instrument in writing and duly registered.

• Mode of transfer: Immovable property is commonly transferred to a private trust by way of a registered gift deed or other conveyance, as may be appropriate on the facts and the trust deed.

• Tax and duty: While transfers by gift may be tax-neutral in certain circumstances under the Income-tax Act, 1961, stamp duty on a gift deed is typically levied as a percentage of the property value (often comparable to conveyance duty) and varies by state.

• State-specific concessions: Certain states prescribe concessional duty for gifts among specified relatives; however, such concessions may not extend to gifts to a trust, and must be verified.

• Alternative structuring: Where immovable property is held through a company, transfer of shares (instead of the underlying immovable property) may be evaluated, subject to corporate, tax, and stamp considerations.

7. Transfer of Shares to a Trust

• Transfers of shares to a private trust may attract stamp duty implications under the Indian Stamp Act, 1899, particularly pursuant to the amendments operationalised through the Finance Act, 2019.

• Under the prevailing framework, stamp duty is typically levied on delivery-based transfers of securities involving consideration; the rate and base (market value/consideration) are governed by the applicable provisions (including Section 9A and relevant rules/notifications).

• Where shares are transferred without consideration (e.g., as part of succession planning), the transaction may be treated as a gift for stamp purposes; the levy (including any nominal duty or exemption) is state-specific and must be examined in the relevant jurisdiction.

• For dematerialised securities, stamp duty is collected through the depository/clearing corporation mechanism and remitted to the appropriate state government; for physical securities, duty is ordinarily reflected on the relevant transfer instrument.

8. Dissolution of a Private Trust

8.1 Overview

• Dissolution denotes the formal termination/closure of the trust and the consequential distribution of its assets upon settlement of liabilities, strictly in accordance with the trust deed and applicable law.

• The process generally requires appropriate trustee action (including resolutions/minutes), preparation of final accounts, and completion of related statutory and banking closures, as applicable.

8.2 Documents Typically Required

• **Deed of Dissolution:** Records dissolution, settlement of liabilities, and distribution of assets; advisable to register.

• **Trustees' Resolution/Minutes:** Resolution approving dissolution, signed by trustees.

• **Final Accounts:** Statement of liabilities settled and assets distributed.

• **Intimations/Closures:** PAN/bank and other statutory closures, as applicable.

CONCLUSION

In conclusion, a private trust is an effective legal mechanism for holding and administering assets for determinate beneficiaries, provided that the trust deed is clearly drafted and the applicable requirements relating to stamping, registration (where required), and asset transfer formalities are duly complied with. As stamp duty and allied procedural requirements are largely state-specific and outcomes are fact-dependent, the instrument and implementation steps should be reviewed with reference to the applicable law prior to execution.

THANK YOU...

Email : dipen@ddsaca.com
info@ddsaca.com

Office Landline : +91-79-40039647