

The Taxman and the Trust

Mar 13, 2026



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I. The Succession Planning Imperative

The question of inter-generational wealth transfer has become mainstream conversation for Indian promoter families. A will, the default instrument for succession, is proving to be insufficient on its own. Wills operate only upon death, deal solely with assets, and is silent on the continuity of management and governance.

A private trust, properly structured, not only allows smooth succession of personal assets, but also enables the promoter to segregate management from ownership, define economic and voting rights across generations, provide for passive family members without ceding control, and hard-wire conflict resolution, all during the promoter's lifetime. A Family Charter may sit alongside the trust, to record shared promoter family values and decision-making principles. The trust deed and any accompanying shareholders' agreement convert intent into enforceable rights.

Given this backdrop, a precise understanding of the income-tax implications at each stage of a trust's lifecycle is indispensable.

II. Types of Private Trusts

Private trusts are classified along two axes. The first is revocability. An irrevocable trust involves a permanent and unconditional transfer of assets to the trustee for the benefit of the beneficiaries of the trust; the trust subsists until its objects are fulfilled or it is dissolved. A revocable trust preserves the settlor's right to revoke or modify the trust. For income-tax purposes, the Income-tax Act, 1961 (the "1961 Act") treats a transfer as revocable under Sections 61 to 63 where the transferor retains the right to reassume power over the income or assets^[1].

The second axis is the nature of beneficial interest. A specific (or determinate) trust fixes the shares of beneficiaries ascertainably in the trust deed. A discretionary trust identifies a

class of beneficiaries but leaves the trustee the discretion to determine the proportion in which income or corpus is distributed. The tax implications of this classification are profound.

III. Taxation at the Time of Contribution

The contribution of assets by the settlor to a trust engages two provisions. First, the transfer of a capital asset by an individual to an irrevocable trust is excluded from the definition of "transfer" under Section 47(iii) of the 1961 Act^[2] and accordingly, does not attract capital gains tax in the hands of the transferor.

Second, from the recipient trust's perspective, Section 56(2)(x) of the 1961 Act^[3] taxes the receipt of money or property without consideration or for inadequate consideration as income from other sources. A specific carve-out exempts receipts by a trust from an individual where the trust is created *solely* for the benefit of "relatives" of that individual. Two features of this exemption warrant careful attention.

(a) The Perspective Asymmetry

Direct gifts received from relatives are also not taxable pursuant to Section 56(2)(x). This relationship is tested from the recipient's perspective; a gift from an uncle to a niece is exempt since a brother or sister of one's parents qualifies as a "relative" from the niece's vantage point. However, for contributions to a trust, the exemption is tested from the contributor's perspective. Since a niece is not a "relative" of the uncle under the statutory definition, a trust settled by the uncle for the benefit of nephews and nieces would not qualify for such exemption. Consequently, the same economic substance is treated differently depending solely on the route adopted.

The Select Committee on the Income-tax Bill, 2025 acknowledged this asymmetry but classified it as a "policy issue" without amending the provision. Broader definitions of "relative" that include lineal descendants of a brother or sister already exist in certain other provisions of the 1961 Act; however, the asymmetry in section 56(2)(x) is conspicuous by its absence. Alignment with these definitions would restore logical reciprocity.

(b) The "Solely" for the Benefit of Relatives Condition

The exemption is available only where the trust is established "solely" for the benefit of relatives. Tribunal jurisprudence has affirmed that any enabling provision permitting the addition of non-relatives as beneficiaries, even if unexercised, vitiates the exemption. In *Buckeye Trust (Bangalore ITAT)*, a trust deed allowing persons beyond the defined relatives to be added as beneficiaries was held to fall outside the exemption, even if it was only an enabling provision.^[4] Trust deeds must, therefore, confine the class of beneficiaries to statutory relatives without any residual discretion to expand it.

IV. Taxation of Income of the Trust

The taxing provisions for trust income depend on the intersection of the two axes described above. In a revocable trust, whether specific or discretionary, the income is clubbed in the hands of the settlor under the provisions relating to revocable transfers, and the trust does not function as a separate taxable entity.^[5]

(a) Irrevocable Specific Trust

The trustee is assessed as a representative assessee under Section 160 of the 1961 Act^[6]. Under Section 161 of the 1961 Act^[7], the trustee is liable to tax "in the like manner and to

the same extent" as the beneficiary. Each beneficiary's proportionate share of the trust income is taxed at that beneficiary's individual slab rate, preserving the character of the income (capital gains, dividends, interest, and so forth) as it passes through the trust.

(b) Irrevocable Discretionary Trust

Where the shares of beneficiaries are indeterminate, Section 164 of the 1961 Act^[8] mandates taxation at the maximum marginal rate ("MMR") as defined under Section 2(29C) of the 1961 Act. Two critical issues arise.

The Surcharge Question: The definition of MMR under Section 2(29C) of the 1961 Act refers to the rate of income-tax "including surcharge on income-tax, if any" applicable in relation to the highest slab. The Special Bench of the Mumbai ITAT, in *Araadhya Jain Trust* (April 2025), held that while the basic tax rate must be the highest slab rate, the words "if any" signify that surcharge retains its graduated character and must correspond to the trust's actual income slab.^[9] However, the 2025 Act defines MMR under Section 2(70) without the qualifier "if any", potentially mandating the highest surcharge irrespective of actual income. The *Araadhya Jain* ruling may therefore have limited application under the new act.

Preservation of Special Rate: Even where MMR applies, it is confined to ordinary income. Long-term capital gains and short-term capital gains chargeable under Sections 111A and 112/112A of the 1961 Act^[10] continue to be taxed at their applicable special rates. Further, where the trust income comprises of normal income such as dividend or interest income, MMR would be applicable.^[11]

V. Taxation at the Time of Distribution

The distribution of income or corpus from a trust to its beneficiaries does not constitute a taxable event in the hands of the beneficiaries. The beneficiary receives trust property by virtue of a pre-existing beneficial interest, and such receipt cannot be characterised as being "without consideration" within the meaning of Section 56(2)(x). Further, the income has already borne tax at the trust level, and taxing it again in the beneficiary's hands would amount to impermissible double taxation.

This position has been upheld in a consistent line of Tribunal decisions. In *Ashok C. Pratap*^[12], the Tribunal held that amounts received by a beneficiary on dissolution of a private family trust fell outside the scope of then Section 56(2)(vi).

VI. Administrative and Miscellaneous Provisions

Representative Assessee and Filing Obligations: The trustee is recognised as the representative assessee under Section 160 of the 1961 Act and must file the trust's return of income. The trustee, therefore, must obtain a separate Permanent Account Number. The trustee's personal income is assessed separately.

Right of Direct Assessment: The Assessing Officer may, under Section 166 of the 1961 Act^[13], tax either the trustee or the beneficiary directly; however, once the choice is exercised for a year, it cannot be reversed. The Karnataka High Court in *Smt. Indramma*^[14] confirmed that assessment can be made either on the trustee or on the beneficiary, but not on both, by virtue of Section 166 read with CBDT Circular No. 157 of 1974.

Recovery from the Trust Estate. Section 162 of the 1961 Act^[15] empowers the representative assessee to recover tax paid from the trust estate. The trustee is not

personally liable for tax beyond the assets of the trust.

VII. When an Irrevocable Trust May Be Deemed Revocable

A trust described as "irrevocable" in its deed may nevertheless be treated as revocable for income-tax purposes. Section 63 of the 1961 Act defines a revocable transfer broadly to include any transfer containing a provision for the re-transfer, directly or indirectly, of the income or assets to the transferor, or in any way gives the transferor a right to re-assume power directly or indirectly over the whole or any part of the income or assets.^[16] This encompasses not merely an express power of revocation, but also indirect mechanisms: where the settlor retains power to modify beneficial interests in a manner that restores dominion over the trust property, or where the trust deed permits any person to reassume power over the income or assets on behalf of the settlor. Bangalore ITAT in the case of India Advantage Fund VII^[17] held that such power of revocation could be at the instance of any person, the settlor / transferor, trustees, or beneficiaries, and the 1961 Act does not contemplate a power of revocation only at the instance of the transferor.

In such cases, the income of the trust is clubbed in the settlor's hands under Section 61 of the 1961 Act, defeating the intended architecture. The trust deed must ensure a complete and unqualified divestiture by the settlor, without any residual power that could attract the revocable transfer provisions.

VIII. The Big Picture

A private trust, when deployed as part of a considered succession architecture, is far more than a tax or estate duty vehicle. It can serve as the instrument through which management roles are allocated, governance norms are codified, exit frameworks are established for passive family members, and special provisions are made for minors, dependants, or members residing overseas. Its utility spans both tracks of succession planning: the transfer of assets and the continuity of control. The tax framework, as discussed in this article, is a critical but not the sole dimension. The income-tax regime for private trusts is not straightforward, and the transition to the 2025 Act raises fresh questions, particularly around the computation of maximum marginal rate and the persisting asymmetry in the definition of 'relative' for trust contributions.

The underlying architecture, however, remains sound: an irrevocable trust can receive assets free of capital gains, earn income that is taxed either at its beneficiaries' individual rates or at defined statutory rates, and distribute both income and corpus without further tax incidence. That said, this architecture is only as robust as the trust deed that supports it. A loosely drafted clause, whether it permits the future addition of non-relatives, retains an ambiguous power of revocation, or leaves beneficial interests imprecisely defined, can undo the entire structure. The trust deed deserves the same rigour and deliberation that one would accord to any foundational corporate instrument.

^[1] Sections 97 and 98 of the Income Tax Act, 2025

^[2] Section 70(1)(b) of the Income Tax Act, 2025

[3] Section 92(3) of the Income Tax Act, 2025

[4] Buckeye Trust v PCIT [\[TS-164-ITAT-2026\(Bang\)\]](#)

[5] Section 61 to 63 of the Income-tax Act, 1961

[6] Section 303 of the Income Tax Act, 2025

[7] Section 304 of the Income Tax Act, 2025

[8] Section 307 of the Income Tax Act, 2025

[9] Araadhya Jain Trust v. ITO, Mumbai ITAT (Special Bench), [\[TS-5310-ITAT-2025\(Mumbai\)-O\]](#)

[10] Sections 196 to 198 of the Income Tax Act, 2025

[11] CIT v. TAV Trust [\[TS-5284-HC-2003\(Kerala\)-O\]](#)

[12] Ashok C. Pratap v ACIT [\[TS-5915-ITAT-2012\(Mumbai\)-O\]](#)

[\[13\]](#) Section 304(3) of Income Tax Act, 2025

[\[14\]](#) CIT v Smt. Indramma [\[TS-5825-HC-2011\(Karnataka\)-O\]](#)

[\[15\]](#) Section 305 of Income Tax Act, 2025

[\[16\]](#) Section 63 of the Income-tax Act, 1961

[\[17\]](#) DCIT v India Advantage Fund – VII [\[TS-648-ITAT-2014\(Bang\)\]](#)