A GOSAR FAMILY TRUST, JAMNAGAR ETC.

v.

COMMISSIONER OF INCOME TAX

APRIL 28, 1995

B [B.P. JEEVAN REDDY, S.C. SEN, AND G.T. NANAVATI, JJ.]

Indian Trust Act 1882—Discretionary Trust created with two categories of beneficiaries—First category entitled to trust income—Second category to get the corpus of the trust and all the income accumulated at the end of the
C *trust—Held : Second category is beneficiary.*

Income Tax Act 1961—Section 164(1) and Proviso (i)—Trust created with two category beneficiaries—First category to get trust income—Second category to get corpus and income at the end of the Trust—First category beneficiaries having no taxable income under the proviso—The second
D *category falling under the proviso—Rates for charging tax of the trust income—Held: Charging of trust income at maximum marginal rate not contrary to law—Policy of law to discourage discretionary trust.*

Words & Phrases—"Beneficiaries"—Meaning of—To be construed and
E *understood in its ordinary and normal sense—No distinction between the two categories of beneficiaries—So for as income of the trust concerned—Since no distinction made between beneficiaries and beneficiaries by the income tax act, section 184(1) or Proviso (i).*

By way of a deed a private trust of discretionary nature was created.
F **There were 2 sets of beneficiaries to the trust. One of the beneficiaries was common to both the sets. According to recitals of the trust deed, the life of the trust was 18 years which could be terminated after a period of 2 years at the discretion of the trustees. The trust income was to go to the first category beneficiaries and the second category beneficiaries were to**
G **get the corpus of the trust and all the income accumulated at the end of the trust. Further the trustees had right to invest the funds in any firm or joint stock company in which any one or more of the trustees were partners, directors or share holders.**

For assessing the trust the Revenue, finding none of the first
H **category beneficiaries having taxable income under the Act within meaning**

of proviso (i) to sec. 164 (i) and second category beneficiaries having such income - charged the trust at maximum margined rate treating the second category beneficiaries for the purpose of proviso (i). A

On appeal the tribunal held that the rate applicable was the rate relevant to the association of persons by virtue to proviso (i) to section 164 (i). B

At the instance of the Revenue the case was referred to High Court. The High Court decided in favour of Revenue holding that proviso (i) was not attracted in this case and therefore the income is chargeable at the maximum marginal rate. C

Dismissing the appeal, this Court

HELD : 1.1. The second category beneficiaries are also beneficiaries as rightly pointed out by the High Court. Indeed there is no distinction between the two categories, so far as the income of the trust is concerned. D The members of the first category have no right to demand or receive income. They may or may not receive any income. It may well happen that they may not get a single pie either in the year concerned or during the entire period of the trust. The second category beneficiaries too have no right to the income but yet they may get whole of it or such part of it as may not have been distributed or paid to first category. Thus neither E category has a right but only an expectation to receive income. In this sense, members of the second category are as much beneficiaries as the members of the first category. The trustees are entitled to choose not to pay a pie out of the income to any one and invest the whole of it in their own concerns. [902-F, G, 903-A, B] F

1.2. The trustees were under no obligation to disburse or distribute the income received in an year in that year or in the following year and the income not distributed ultimately goes to second category. It is immaterial whether that income becomes part of corpus or not. What is material is G that it goes to the second category. In absence of such obligation, it cannot be said that the trust income is receivable by the trustees on behalf of or for the benefit of the first category beneficiaries. [903-B, E, F, G]

1.3. For the purpose of section 164(i), what is relevant is that the income is receivable on behalf of the beneficiaries. It is not necessary that H

A **the income is received by the beneficiaries. It is therefore difficult to say in the light of the recitals of the trust deed that the income is receivable only on behalf of the first category but not on behalf of the second category beneficiaries. Indeed section 164(i) or the proviso (i) thereto does not make any distinction between beneficiaries and beneficiaries - nor is the said expression defined in Act. It would, therefore, be reasonable to construe and understand the expression "Beneficiaries" in its ordinary and normal sense, which means that both categories are beneficiaries. Therefore charging of maximum marginal rate is not contrary to law. [903-C, D, G]**

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Commissioner of Income Tax v. *B.A. Sanghrajka Trust,* **181 ITR 484, distinguished.**

C

Commissioner of Income Tax v. *Mrs. Pushpahne Family Trust,* **207 ITR 587, referred to.**

2. The policy of law as disclosed from section 164 (1) is to discourage discretionary trusts by charging the income of such trusts in the hands of trustees at the maximum marginal rate except in certain specified situation. The trust deed concerned herein is a discretionary trust of an extremely unusual type. [904-C]

D

E CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1180 of 1991 Etc. Etc.

From the Judgment and Order dated 4.10.90 of the Gujarat High Court in I.T.R. No. 74 of 1989.

F U.V. Eradi and P.H. Parekh for the Appellants.

Ramamurthy, Ranbir Chander, Ms. A. Subhashini and Mr. P. Parameshwaran for the Respondents.

The Judgment of the Court was delivered by

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B.P. JEEVAN REDDY, J. Leave granted in Special Leave Petitions.

A common question arises in this batch of appeals. For the sake of convenience and with the consent of the counsel for the parties, we treat the facts in Civil Appeal No. 1180 of 1991 (Gosar Family Trust, Jamnagar)

H as representative of the facts in all the cases. It is agreed by the learned

counsel for the appellants that the relevant recitals in the Trust Deeds concerned in all the appeals are identical. The appeals arise from the judgment and orders of the Gujarat High Court.

The High Court has answered the following two questions referred to it, at the instance of the Revenue, under Section 256(2) of the Income Tax Act in favour of the Revenue and against the assessee:

> "(1) Whether, in law and on facts and having regard to the provisions of sub-section (1) of section 164 of the Income- tax Act, 1961, the assessee is entitled to the concessional rate of tax?
>
> (2) Whether, in law and on facts and in view of the provisions of the trust deed, the trust cannot be subjected to maximum marginal rate of tax?"

By a deed dated October 3, 1981, Sri Hirji Pethraj Shah created a private trust known as "Gosar Family Trust". S/Sri Devchand Shamji Shah, (2) Sri Deepak Devchand Shah, (3) Smt. Ladhiben Shamji Shah and (4) Smt. Sunanda Rajesh Shah were named as trustees. The trust was created with a sum of Rupees five hundred. Clause (7) of the Trust Deed, however, permitted the trustees to accept from any person desirous of making contributions to the Trust fund such amounts or properties and upon such terms and conditions as they may think fit subject, of course, that the objects of the contributions are not inconsistent with the objects of the trust. There are two sets of beneficiaries. The first category comprises three individuals, viz., (1) Sri Gosar Devashi Jakharia, (2) Smt. Lakhmaben Gosar Jakharia and (3) Sri Mukesh Gosar Jakharia. (Nos. 2 and 3 are wife and son respectively of No. 1). The second category of beneficiaries are : (1) Smt. Lakhmaben Gosar Jakharia, (2) family members of Sri Devchand Shamji Shah and (3) Smt. Kankuben Gulabchand Shah upto three generations. The recitals in the trust deed are little unusual and may be noticed (as condensed by us):

(1) The life of the trust is eighteen years. But after the expiry of two years, the trustees have the discretion to terminate the trust at any time.

(2) With respect to the income from the trust properties, the trustees have been given an absolute discretion to distribute the same among the first category beneficiaries in such manner and in such proportion and at

A such times as they think appropriate. The trustees are vested with absolute discretion not to distribute the income to any one and to accumulate it.

(3) At the end of eighteen years or at such time as the trustees put an end to the trust, the corpus of the trust and all income accumulated, if any, shall be distributed among the second category beneficiaries, again in
B such proportion and in such manner as the trustees may decide.

(4) The trustees have been expressly empowered to invest the trust funds in any firm or joint stock companies in which any one or more of the trustees may be partners, directors or share- holders, as the case may be.

C The trust is undoubtedly a discretionary trust. The only question in this appeal is whether the income of the trust taxed in the hands of the trustees is chargeable at the maximum marginal rate or at the rate applicable to the association of persons within the meaning of Section 164(1) of the Income Tax Act. While the Tribunal has held that the rate applicable
D is the rate relevant to the association of persons by virtue of proviso (i) to Section 164(1), the High Court is of the opinion that proviso (i) is not attracted in this case and, therefore, the income is chargeable at the maximum marginal rate. It would be appropriate to read Section 164(1) insofar as it is relevant at this stage :

E *"Charge of tax where share of beneficiaries unknown.*

164. (1) Subject to the provisions of sub-sections (2) and (3), where any income in respect of which the persons mentioned in clauses (iii) and (iv) of sub-section (1) of section 160 are liable as representative assessees or any part thereof is not specifically receivable
F on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown (such income, such part of the income and such persons being hereafter in this section referred to as "relevant
G income", "part of relevant income" and "beneficiaries", respectively), tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate:

Provided that in a case where—

H (i) none of the beneficiaries has any other income chargeable

> under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust.....
>
> (Clauses (2), (3) and (4) omitted as unnecessary.)
>
> tax shall be charged on the relevant income or part of relevant incomes as if it were the total income of an association of persons:
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> (Rest of the section omitted as unnecessary.)

The sub-section contemplates charging of tax at maximum marginal rate in two situations, viz., (a) where any income, in respect of which the trustees (omitting unnecessary categories of persons) are liable to be assessed as representative assessees, is not specifically receivable on behalf or for the benefit of any one person and (b) where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown. The first proviso, however, says *inter alia* that where none of the beneficiaries has any other income chargeable under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust, tax shall be charged on the relevant income as if it were the total income of an association of persons. In this case, none of the first category beneficiaries has taxable income under the Act within the meaning of proviso (i), while the second category beneficiaries do have such income. This means that if the second category beneficiaries are also treated as beneficiaries for the purpose of proviso (i), the trust income is liable to be charged at the maximum marginal rate. If, on the other hand, only the first category beneficiaries are treated as beneficiaries (and not the second category beneficiaries) within the meaning of proviso (i), then the trust income is liable to be charged in the hands of the trustees at the rate applicable to the association of persons. For this reason, the assessees' contention has been that only the first category beneficiaries are beneficiaries within the meaning of proviso (i) while the Revenue contends to the contrary. The reasoning of the High Court on which it has held against the assessee is to be found in the following three paragraphs:

> "There is no dispute about the fact that the income was not specifically receivable on behalf of or for the benefit of any one person and that the individual shares of beneficiaries were indeter-

A minate or unknown. Therefore, the provisions of section 164(1) are attracted to the type of arrangement made under this trust. The argument that only the first set of beneficiaries who may receive the income are the class envisaged by sub-section (1) of section 164 and not the type of beneficiaries who may, ultimately, get the accumulated income on distribution is not warranted by the word-
B ing of the provision which includes the entire class of beneficiaries on whose behalf or for whose benefit the income is receivable by the trustee.

The trustees receive or are entitled to receive the income
C (under the deed) on behalf of or for the benefit of both the sets of beneficiaries and are their representative assessees under section 160(1)(iv). It cannot be said that they do not receive the income for the benefit of the second set or "tier" of beneficiaries (described as corpus beneficiaries). The trustees are empowered
D to accumulate the income for the benefit of the second set of beneficiaries and, therefore, they receive or are entitled to receive the income on behalf of or for the benefit of such second set of beneficiaries also notwithstanding the existence of the first set of beneficiaries to whom they may distribute the income if they so choose to do. The existence of the authority of the trustees to
E disburse the income they receive under the trust to the first set of beneficiaries does not militate against their entitlement to receive the income on behalf of or for the benefit of the other set for whom they can legitimately accumulate it for eventual distribution. The trustees were entitled to receive the income under this trust on
F behalf of or for the benefit of the entire class of beneficiaries notwithstanding the fact that they had a discretion to bestow the benefit to one beneficiary or one set of beneficiaries at the cost of the others. The fact that the income so received is disbursed to some and not to others or is disbursed now or accumulated for future disbursement should make no difference and will not change
G the nature of the arrangement made under the trust, namely, that the trustees receive or are entitled to receive the income for the benefit of or on behalf of the entire class of beneficiaries named in the trust.

H The fact that the trustees are not obliged to disburse the income

or accumulate it for the benefit of the first set or the second set of beneficiaries or any of them would itself indicate that the income is receivable by the trustees for the whole class of beneficiaries irrespective of the ultimate manner in which the income is distributed."

The High Court further pointed out that for the purpose of Section 164, it is not necessary that the beneficiaries do actually receive the income. It is sufficient, it held, that the income is receivable by the trustees for the benefit of the persons named in the trust. The High Court observed, "the real question is whether the persons named in the trust have an interest, whether vested or contingent, in the income that is receivable on their behalf" and answered the question by saying that both the categories of beneficiaries mentioned in the trust deed have an interest in the trust and the income of the trust is received by the trustees on their behalf.

Sri Eradi, learned counsel for the assessees contended that the second category of beneficiaries cannot be called "beneficiaries" with respect to the income of trust for the reason that they are not entitled to any portion of income; they are entitled only to the corpus. Only the first category beneficiaries are entitled to the income of the trust, it is submitted. When Section 164 speaks of income and it being taxed at a particular rate, it is having in mind the particular year in which the income is received by the trustees and is being taxed in their hands. Counsel further submitted that even if the trustees decide not to distribute the income and accumulate it, it forms part of the corpus which is distributed among the second category beneficiaries at the end of eighteen years or earlier whenever the trust is put an end to by the trustees in their discretion. Strong reliance is placed upon the decision of the Bombay High Court in *Commissioner of Income Tax* v. *B.A. Sanghrajka Trust,* 181 ITR 484 where construing similar terms of a trust deed, the Bombay High Court held that the second category beneficiaries cannot be treated as beneficiaries within the meaning of proviso (i). It is brought to our notice that the said decision has been followed later by the same High Court in *Commissioner of Income Tax* v. *Mrs. Pushpaben Family Trust,* 207 ITR 587.

We must say that the trust deed in question is rather a curious one. It is effective only for a limited period which can be as short as two years. If, in case, the trustees do not choose to put an end to the trust, even then

A the maximum life of the trust is eighteen years only. One beneficiary is common to both the first and second categories, viz., Smt. Lakhmaben Gosar Jakharia. The trustees are not obliged to disburse or distribute the income among the first category beneficiaries in the year they receive it. They need not pay a single pie to any of the beneficiaries in the first category at any time during the currency of the trust; they are entitled to B accumulate the whole income which will then pass to the second category beneficiaries as and when the trust comes to an end. In other words, the first category beneficiaries have no *right* to receive the income. So have the second category beneficiaries no *right* to receive any income though they may ultimately get the whole or part of the income along with the corpus C on the expiry of the period of trust. The trustees are expressly entitled to deposit the monies of the trust fund in any firm or joint stock company in which any one or more of them is/are partners/directors/share-holders, which means that the trustees could as well have decided not to distribute a single pie and invest all the income and corpus fund for the full period of eighteen years in their own firms and concerns. No less surprising is the D provision that the trust started with a mere Rupees five hundred and the trustees have been given absolute discretion not only in the matter of distribution of income but also in the matter of very continuance of the trust. At any time after the expiry of two years they can put an end to it if they so choose.

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The ingenuity of the assessee and the naivete of the department in espousing and accepting such a trust is remarkable. Be that as it may, we have to answer the question, whether the second category beneficiaries are not "beneficiaries" within the meaning of proviso (i) to Section 164(1) on F the above facts? We are of the considered opinion that the second category beneficiaries are also beneficiaries as rightly pointed out by the High Court. If the income is not distributed among the first category beneficiaries, the whole income - or such part of it as may not have been distributed among the first category - goes to the second category. There is no reason why it cannot be said that the income is received by the trustees on behalf of both G the categories of beneficiaries. Indeed, there is no distinction between the two categories so far as the income of the trust is concerned. The members of the first category too have no *right* to demand or receive income. They may or may not receive any income. It may well happen that they may not get a single pie either in the year concerned or during the entire period of H the trust. If so, how it is being said that income is being received on their

behalf. The second category beneficiaries too have no right to the income but yet they may get whole of it or such part of it as may not have been distributed or paid to first category. Thus, neither category has a *right* but only an expectation to receive income. In this sense, members of the second category are as much beneficiaries as the members of the first category. The trustees are entitled to choose not to pay a pie out of the income to any one and invest the whole of it in their own concerns. They were also under no obligation to disburse or distribute the income received in an year in that year or in the following year. For the purpose of Section 164(1) what is relevant is that the income is receivable on behalf of the beneficiaries. It is not necessary that the income is received by the beneficiaries. It is, therefore, difficult to say in the light of the recitals of the trust deed that the income is receivable only on behalf of the first category but not on behalf of the second category beneficiaries. Indeed, Section 164(1) or the proviso (i) thereto does not make any distinction between beneficiaries and beneficiaries - nor is the said expression defined in the Act. It would, therefore, be reasonable to construe and understand the expression "beneficiaries" in its ordinary and normal sense, which means that both categories are beneficiaries. Situation could probably have been different if there had been an *obligation* upon the trustees to distribute the income received in an year in that very year or in the following year(s) in which event it could probably be said that the trust income is receivable by the trustees on behalf of or for the benefit of the first category beneficiaries only. In this case, there is no such obligation and the income not distributed ultimately goes to the second category. It is immaterial whether that income becomes a part of corpus or not. What is material is that it goes to the second category. It cannot, therefore, be said that income is received only on behalf of the first category and not the second category beneficiaries. Either category could have received the income wholly to the exclusion of the other or both could have received it partly in the manner explained above. We are, therefore, unable to agree with the contentions urged by the learned counsel for the assessees. The charging of maximum marginal rate was not contrary to law.

Now, coming to the decision of the Bombay High Court in *Sanghraj-ka Trust,* the High Court has construed the trust deed concerned therein to mean that the daughter-in-law (comparable to second category in our case) had no right or interest in the income of the trust for any year but it did not attach sufficient importance to the other recital in the trust deed

A that the trustees were entitled in their discretion not to disburse any income to the grand daughters (comparable to first category in our case) of the settler in which case the entire income would have gone to the daughter-in-law at the expiry of the trust. The daughter-in-law may not have had a *right* to the income of the trust, but so did the grand daughters too did have no right. The said decision, therefore, cannot advance the case of the B appellants herein.

We must say that the policy of law as disclosed from Section 164(1) is to discourage discretionary trusts by charging the income of such trusts in the hands of trustees at the maximum marginal rate except in certain C specified situations. The trust deed concerned herein is a discretionary trust of an extremely unusual type. Since it is stated that the Tribunal has found the trust deed to be a genuine one, we do not wish to say anything more on this score.

For the above reasons, the appeals fail and are dismissed with costs.

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K.K.T. Appeals dismissed.