

ITAT denied 'Pass through' status to trust as its beneficiaries were unknown

Summary – The Chennai ITAT in a recent case of TVS Investments iFund., (the Assessee) held that In order to form a determinate trust, under section 164, beneficiaries should be known and individual share of those beneficiaries should be ascertainable as on date of trust deed

Facts

- The assessee was an AOP Trust, which was formed to receive unit contributions from High Net worth Individuals ["HNIs"] towards the capital amount committed by them as per the terms of contribution agreements and provided return on such investments.
- Subsequently, TSG Fund was formed as a SEBI registered VCF. After the registration of TSG Fund with SEBI, it was felt desirable to transfer the commitments from the assessee fund to TSG Fund.
- The roll-over of commitments was undertaken in most of the cases based on the expression of consent. As on 31-3-2009, all but 17 investors had expressed their consent to roll-over commitment to TSG Fund. The assessee Trust, therefore, out of its earnings from bank deposits credited the proportionate value corresponding to the 17 investors to the profit and loss account and transferred the balance relating to the rolled over 639 contributors to TSG Fund and excluded the same from the income.
- The assessee's case was that it had offered the proportionate value relating to the 17 contributors retained. Even this income was brought to zero, since the assessee treated itself as a Representative Assessee, by which the profits were transferred to the hands of the beneficiaries which get taxed in their hands.
- The Assessing Officer having rejected assessee's claim, brought the entire receipt to tax.
- The Commissioner (Appeals) upheld the order of AO.
- On second appeal:

Held

- The income of Alternate Investment Funds [AIFs in short], other than Venture Capital Funds, will not be exempt under section 10(23FB) and there is no specific provisions in the Act for such other AIFs. Therefore, taxation of such funds, like that of the assessee, would depend on the legal status of the fund *i.e.* company, limited liability partnership or trust. If the fund is setup as a trust, then it will be taxed on the principles of taxation of trusts. The income of a trust would be subject to tax as per the principles of taxation of trusts under sections 161 to 164 of the Act. For a trust to be taxed under these sections, there are certain tests to be satisfied, such as, the trust has to be an irrevocable and determinate trust. It should further be a non-discretionary trust.

- Section 164 reads as "Charge of tax where share of beneficiaries unknown" lays down the conditions to give "pass through" status to a trust. As per *Explanation 1* to the section, the trust shall be considered to be a 'determinate trust', if it fulfils two conditions:
 - (i) name of the beneficiaries are specified in the trust; and
 - (ii) the individual share of the beneficiaries is ascertainable on the date of the trust.

Therefore, it is essential that the deed of trust itself specifies the category of the beneficiaries therein and prescribes the methodology for determination of share of each beneficiary; such trust shall be a determinate trust.

- As per section 164(1), if the trust does not satisfy the above test of determinacy, then the income of trust would be chargeable to Maximum Marginal Rate (MMR), subject to certain exceptions as laid down in the section. However, if the trust satisfies the test, then the trust will be treated as "pass through" conduit subject to the provisions of section 160. By virtue of section 160, the department has an option to assess the tax in the hands of the beneficiary or in the hands of the trustee, as the case may be. Section 160 lays down the meaning of representative assessee who shall be deemed to be an assessee for the purposes of the Act. Section 160(1)(iv) states that trustee(s) appointed under a trust will be treated as representative assessee, in respect of income received or income which the trustee is entitled to receive on behalf of any of the beneficiaries under a trust.
- Further, section 161 read with section 160(1)(iv), a trustee of a trust is treated as a representative assessee, and the representative assessee is liable to pay tax on the income in respect of which he is a representative assessee, "in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him".
- For getting a "pass through" treatment, the trust should be a determinate and non-discretionary trust. In order to form a determinate trust, under section 164, the beneficiaries should be known and the individual share of those beneficiaries should be ascertainable as on the date of trust deed. But in the case under consideration the beneficiaries are not incorporated in the trust deed. The investment manager gathers the funds from the contributors and the benefit is passed on to the contributors based on their proportion of investments in the assessee trust. The exception to this rule, and providing "pass through" status to a trust, even though the contributing beneficiaries are not mentioned in the Deed of Trust, is only extended to AIF (VCF) which are Registered with SEBI and eligible for exemption under section 10(23FB) read with section 115U of the Act.
- The Assessing Officer has concluded that the assessee is not a determinate trust and when not found eligible for deduction under section 10(23FB) of the Act as an alternate, cannot be extended the benefit of section 164 of the Act. The "pass through" status has been denied since the assessee is neither determinate trust nor non-discretionary trust and therefore, the income gets taxed in the hands of the representative assessee and not in the hands of the beneficiaries.

- Since on the date of institution of the trust deed, the identities of the contributors/beneficiaries are not known, the Commissioner (Appeals) held that the assessee trust cannot be categorised itself as a Determinate Trust so as to gain pass through status. Further, pass through status is available only when the trust is an approved fund under section 10(23FB) of the Act. When the assessee is not a SEBI approved Alternate Investment Fund, it cannot claim pass through status. If every trust were to become eligible for pass through status automatically, then there is no need for an enactment under the Act in the form of section 10(23FB) read with section 115U of the Act.
- When this section 10(23FB) finds a firm place in the statute, it construes that all other trusts/funds cannot enjoy pass through status when the names of the beneficiaries were not specified in the trust and the individual shares of the beneficiaries were not ascertainable on the date of the institution of the trust. Therefore, the assessee cannot be categorised as a determinate trust and, consequently, there is find no reason to interfere with the orders of the Commissioner (Appeals).