

Use of Trusts in Wealth Management and Succession Planning

Legal and Tax Perspective

June 2017

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Nishith Desai Associates
LEGAL AND TAX COUNSELING WORLDWIDE

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NDA Private Client Practice

Our Approach

At Nishith Desai Associates, we are mindful of the special relevance of personal wealth planning to each individual and the confidentiality or sensitivity concerns it can involve. We endeavor to act as trusted advisors to our international private clients, who primarily consist of high net worth individuals, global business families with residency/assets/family or obligations across countries, or the banks, trustees and other institutions representing such persons. We are typically called upon to assist with the accomplishment of a broad blend of objectives ranging from succession planning, asset protection, philanthropy, maintenance of dependents to other specialized individual, family and business related concerns.

Wealth planning law in India is complex and multi-layered as it requires simultaneous consideration of various laws including community specific succession laws (which treat Hindus, Muslims, Christians and other religions differently for the purposes of testamentary as well as intestate succession), currency control regulations (which impose restrictions on the manner in which non-residents can own/transfer Indian property or Indian residents can plan their offshore wealth) and tax laws (which are constantly changing and broadening in scope). These, combined with conflict of law principles applicable to family members dispersed across countries, makes the structuring exercise complex and challenging. Our personalized solutions aim to provide options that are workable in the long term and satisfy the wishes of our clients while at the same time being administratively simple, cost effective and compliant with applicable laws.

While we are only authorized to practice Indian law, our private client team comprises of professionals who are qualified in India, UK and the US and who have an understanding of foreign estate, trust and tax laws as well as conflict of laws issues. As a research based law firm, we also constantly update our capabilities through comparative research and analyses, which enable us to manage wealth planning projects spanning multiple jurisdictions and which may require the reconciliation of a personal wealth plan with applicable Indian and non-Indian laws.

Scope of Services

Our private client team provides structuring and advisory services to individuals, business families, trustees, banks and funds on cross border wealth management. Examples of previous instructions are: structuring of carried interest in relation to the use of hybrid entities such as US LLCs/ S-corps for investment holding; structuring for succession of IP assets; characterization of Hindu Undivided Families from a US trust law perspective or civil law private foundations for Indian succession law purposes.

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Preface

The number of Ultra High Networth Households in India has increased by 7% (approximately 146,600) in 2016.¹ These households represent a staggering net worth of approximately INR 135 crore. Of the Ultra High Networth Individual's (UHNI's) interviewed, a significant 98% stated that they believe that succession planning is a continuous and proactive process. This is particularly interesting considering that nearly half of the UHNI's are below the age of 40. The World Wealth Report has also found that 45% of High Networth Individuals (HNWI's) in India seek professional advice on family wealth (highest of all the Asia-Pacific countries) and 21% seek advice with respect to personal wealth.² These results clearly illustrate what we, at NDA, have been seeing as a market trend where UHNI's and HNWI's are taking active steps towards wealth management and succession planning even before the age of retirement.

While Wills have traditionally been the most commonly used tool by which to distribute wealth to future generations, private trust structures are becoming integral to wealth management and succession planning. Unlike Wills which are often challenged before the court, Trusts may be executed during the lifetime of the individual. This unique characteristic not only helps to reduce contentious litigation amongst family members, but also allows the individual some control over the family's assets while still safe guarding family wealth against possible liabilities.

However, the growing tendency of Indian families to include members located across the globe also poses some unique challenges with respect to transferring wealth across country borders. Accordingly, it has become increasingly important to analyze any trust structure or wealth management strategy from a multi-jurisdictional perspective.

The paper seeks to outline the way in which Trusts may be used in India for the purpose of wealth management and succession planning from a legal, regulatory and tax perspective.

1. Kotak Wealth Management, Top of the Pyramid Report. Available at: <http://wealthmanagement.kotak.com/topindia/reports/introduction.html>

2. Capgemini and RBC Wealth Management Global HNWI Insights Survey 2015. Available at: https://www.worldwealthreport.com/reports/wealth_management_approach/asia_pacific/india

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1. Introduction

India has witnessed a steady growth in its high net worth population as a consequence of increasing globalization not only by families and individuals in Tier I cities but also from Tier II and Tier III cities. Although economically the Indian HNI may be a mirror of his/her counterpart in the developed nations, culturally there appears to be a difference in approach. The Financial Times had reported that in the year 2013 Asian families in particular suffered from a cultural reluctance to discuss succession. The report stressed on the need for greater awareness for succession planning since a lot of wealth was locked up in family businesses which needed to be effectively devolved to the next generation.

This observation certainly echoes in India where the majority of businesses today are family-run but most Indian businesses families do not have succession plans in place for personal and/or business wealth. After the liberalization of India, a new breed of mobile, highly-skilled, entrepreneurial high net-worth individuals has emerged. Changing social relationships now pose emerging issues such as inter-family relationships between people spread over multiple countries. Businesses have grown across jurisdictions at an astronomical pace but also faltered where accompanied by leadership crises. There are growing risks in a shrinking world where the legal systems of various countries increasingly overlap.

Effective estate and wealth planning ensures that families retain control over their businesses and a smooth transition of leadership of businesses between generations of families. It balances the needs of businesses with the interests of family members. Effective planning of the wealth of high net-worth individuals can prevent long and expensive legal disputes between heirs based in multiple jurisdictions. Various structures provide different degrees of control over the purpose for which the wealth can be used and the manner in which it may be used. One of the mostly commonly used structures to manage personal assets, including both tangible assets as well intellectual property, and succession planning is the private family trust.

2. Why a Trust?

Trusts originated at the end of the middle ages as a means of transferring wealth within the family and have remained the characteristic device employed for organizing intergenerational wealth transmission in situations where the transferor has substantial assets or complex family affairs.¹ Modern day private trusts are used to carry out this function in India. Public trusts, on the other hand, may be used to contribute property towards religious and charitable purposes.

A private trust offers several advantages, not the least of which is ring-fencing of assets against possible losses due to business liabilities, family related liabilities arising from divorce / maintenance claims, tax claims, re-introduction of estate duty in India, and / or actual or potential creditors. It also provides a mechanism whereby the needs of the entire family are met, including the future needs of young or

unborn children / grandchildren, while allowing the flexibility to provide appropriate benefits to different family members at different points in time, taking into account changing necessities, opportunities, etc., and contributions made by such members for the well-being of the family. While private trusts may be managed by family members, they also provide the flexibility to appoint an unbiased independent person for taking decisions on distribution of wealth to various family members and others. Further, private trusts offer families the ability to bypass the probate process, give heirs the benefit of property without losing control of it, create a large pool of funds for making investments, structure business succession which may be based on a balance of merit and family control, and facilitate philanthropic activities all through one centralized and cost effective administrative body.

1. John H Langbein, "The Contractarian Basis of the Law of Trusts", 105 YALE L.J 625, 632-43 (1995) cited in The John H Langbein "Secret Life of the Trust: The Trust as an Instrument of Commerce" Available at: http://www.law.yale.edu/documents/pdf/Faculty/Langbein_Secret_Life_of_Trust.pdf >

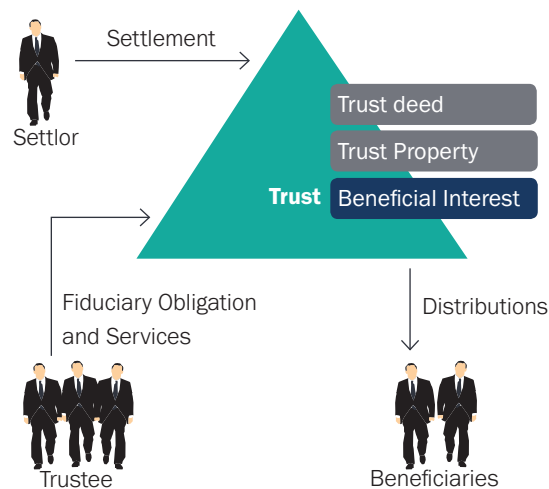
3. What is a Trust?

Trusts in India are governed by the provisions of the Indian Trusts Act, 1882 (“**Trusts Act**”). The trust act is applicable to the whole of India except the State of Jammu and Kashmir and the Andaman and Nicobar Islands. That apart, it is not applicable to the following:

- i. Waqf;
- ii. Property of a Hindu Undivided Family; and
- iii. Public or private religious as charitable endowments.

As per the trust act a trust is *“an obligation annexed to the ownership of property, and 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”*

As depicted in the diagram below, the person who reposes or declares the confidence is called the “author of the trust” (commonly referred to as a ‘settlor’). The person who accepts the confidence is called the “trustee”. The person for whose benefit the confidence is accepted is called the “beneficiary”. The subject matter of the trust is called “trust property”. The “beneficial interest” or “interest” of the beneficiary is the right against the trustee as owner of the trust property. The instrument, if any, by which the trust is declared is called the “instrument of trust” (commonly known as the ‘trust deed’ or ‘indenture of trust’).



In addition to the above-mentioned essential components of a trust, a trust structure may also include a Protector and / or Trust Advisor. The Protector of a trust is a trusted individual, generally known to the family, who advises the trustee in various circumstances. His primary role is to ensure that the views of the family are represented, especially in cases where the trustee may be a non-family member, an institution or a private trust company.² The extent of the Protector's role may be provided for under the trust deed; however, in all cases his recommendations are advisory in nature and are not binding on the trustee. The ultimate decision with respect to any trust matter remains with the trustee or in some cases with the Settlor depending on the structure of the trust.

I. Types of Trusts

As discussed, trusts may be private or public.

A. Private Trusts

A private trust is created for the benefit of specific individuals i.e., individuals who are defined and ascertained individuals or who within a definite time can be definitely ascertained.

A private trust does not work in perpetuity and essentially gets terminated at the expiry of purpose of the trust or happening of an event or at any rate eighteen years after the death of the last transferee living at the time of the creation of the trust.

A person can be settlor of a private trust if he has attained majority (i.e., has completed 18 years of age or in case of a minor, for whom a guardian is appointed by the court or of whose property the superintendence has been assumed by the court of wards the age of majority is 21 years) and is of sound mind, and is not disqualified by any law.

But a trust can also be created by or on behalf of a minor with the permission of a principal civil court of original jurisdiction. Apart from an individual, a company, firm, society or association of persons is also capable of creating a trust.

A family trust set up to benefit members of a family is the most common purpose for a private trust. The purpose of the family trust is for the settlor to progressively transfer his assets to the trust, so that legally the settlor owns no assets himself, but through the trust, beneficiaries get the benefit of these assets. A family trust can be set up either while one is still alive (by a declaration of trust contained in a trust deed) or post death, in terms of a will.

Private family trusts may be set up either *inter vivos* i.e. during a person's lifetime or under a will i.e. testamentary trust, either orally or under a written instrument, except where the subject matter of the trust is immovable property, the trust would need to be declared by a registered written instrument.

A trust can be set up either as:

- i. Revocable: A trust that can be revoked (cancelled) by its settlor at any time during this life;
- ii. Irrevocable: A trust will not come to an end until the term / purpose of the trust has been fulfilled;
- iii. Discretionary: An arrangement where the trustee may choose, from time to time, who (if anyone) among the beneficiaries is to benefit from the trust, and to what extent;
- iv. Determinate: The entitlement of the beneficiaries is fixed by the settlor at the time of settlement or by way of a formula, the trustees having little or no discretion; or
- v. Combination trusts namely: of (i) - (iii)/(iv), (ii)-(iii)/(iv)

Private trusts may also be used as a collective investment pooling vehicles such as mutual funds and real estate investment trusts.

2. Please see section on Key Considerations for more information on individual and institutional trustees, and Private Trust Companies.

B. Public Trusts

A public trust is created for the benefit of an uncertain and fluctuating body of persons who cannot be ascertained any point of time, for instance; the public at large or a section of the public following a particular religion, profession or faith. A public trust is normally permanent or at least indefinite in duration.

As regards the public trusts, there is no Central Act governing formation and administration of such trusts. But various states such as Bihar, Maharashtra, Madhya Pradesh Orissa, etc., have enacted their own legislations prescribing conditions and procedures for the administration of public trusts. These Acts are more or less similar in nature though there may be certain variations.

A public trust is generally a non-profit venture with charitable purposes and in such cases it is also referred to as the charitable trust.

A trust created for religious purposes is termed a religious trust and it can be either a private or a public trust. A religious endowment made via trustees to a specified person is a private trust and

the one to the general public or a section thereof is a public trust. The creation of religious charitable trusts is governed by the personal laws of the religion. The administration of these religious trusts can either be left to the trustees as per the dictates of the religious names or it can be regulated to a greater or lesser degree by statute such as the Maharashtra Public trusts Act, 1950. In case of Hindus, the personal law provisions regulating the religious trusts have not been codified and are found dispersed in various religious books.

There are four essential requirements for creating a valid religious or charitable trust under Hindu Law, which are as follows:

1. valid religious as charitable purpose of the trust as per the norms of Hindu Law;
2. capability of the author of the trust to create such a trust;
3. the purpose and property of the trust must be indicated with sufficient precision; and
4. the trust must not violate any law of the country.

4. Taxation of Trusts

Income tax in India is governed by the Income Tax Act, 1961 ('ITA'), which lays down provisions with respect to chargeability to tax, determination of residence, computation of income, transfer pricing, etc. Residents are ordinarily subjected to tax on their worldwide income, whereas non-residents are taxed only on their Indian source income, i.e. income that accrues or arises to them in India.

I. Private Trust

For the purpose of Indian taxes, a private trust is not regarded as a separate taxable unit. However, a trustee under the ITA acquires the status of the beneficiaries and is taxed in the role of the beneficiaries in a representative capacity. The provisions relating to taxation of trusts are laid out in Section 161-164 of the ITA.

A. Irrevocable Determinate (Specific) trust

In such a trust, the beneficiaries are identifiable and their shares are determinate, a trustee can be assessed as a representative assessee and tax is levied and recovered from him in a like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him (i.e. the beneficiary). The tax authorities can alternatively raise an assessment on the beneficiaries directly, but in no case can tax be collected twice. While the income tax officer is free to levy tax either on the beneficiary or on a trustee in his capacity as representative assessee, the taxation in the hands of a trustee must be in the same manner and to the same extent that it would have been levied on the beneficiary, i.e., qua the beneficiaries. Thus, in a case where a trustee is assessed as a representative assessee, he would generally be able to avail all the benefits / deductions, etc. available to the beneficiary, with respect to that beneficiary's share of income. There is no further tax in the hands of the beneficiary on the distribution of income from a trust.

In relation to assets settled / gifted into an irrevocable trust (both determinate and discretionary), such contribution should not be taxable in the hands of the transferor. This is because such settlement / gift is specifically excluded from the ambit of "transfer" for the purposes of levy of capital gains tax. However, there has been conflicting views in relation to taxation in the hands of the trustee, i.e., the transferee, especially, where one / more beneficiaries of the trust are not "relatives" (as defined) of the transferor.

Up to FY 2016-17, receipt of fund / any property by any "individual" without consideration or for a value less than the fair market value of the property was taxable in the hands of the transferee individual, except where the transferors were "relatives"³ of the transferee. In the context of certain facts, some rulings have held that income of trust should be taxed as the income of an "individual". However, it may be possible that trust income is not taxed as income of an "individual" depending on the facts and circumstances. Further, considering that 'trust' is "an obligation annexed to ownership of property", it is questionable as to whether settlement of property into a trust can be treated as transfer of property without consideration.

Based on recent amendments, from FY 2017-18, the provisions have been expanded such that they are applicable to all transferees and not only individuals. This expansion has been coupled with a specific exclusion for settlement into trusts set up solely for the benefit of "relatives" of the transferor. Therefore, it appears that settlements in other circumstances may be taxable in the hands of the transferee trustee. Having said that, the primary issue it is still unsettled, i.e., as to whether settlement of property into a trust can be treated as transfer of property without consideration.

3. Under Section 56 of the ITA "relatives" has been defined to include:
 (i) spouse of the individual;
 (ii) brother or sister of the individual;
 (iii) brother or sister of the spouse of the individual;
 (iv) brother or sister of either of the parents of the individual;
 (v) any lineal ascendant or descendant of the individual;
 (vi) any lineal ascendant or descendant of the spouse of the individual;
 (vii) spouse of the person referred to in clauses (ii) to (vi);

B. Irrevocable Discretionary trust

A trust is regarded as a discretionary trust when a trustee has the power to distribute the income of a trust at its discretion amongst the set of beneficiaries.

In case of an onshore discretionary trust, with both resident and non-resident beneficiaries, a trustee will be regarded as the representative assessee of the beneficiaries and subject to tax at the maximum marginal rate i.e. 30%.

In case of an offshore discretionary trust with both resident and non-resident beneficiaries (including offshore charitable organisations), a trustee should not be subject to Indian taxes or reporting obligations. However, if all the beneficiaries of such discretionary trust are Indian residents, then a trustee may be regarded as the representative assessee of the beneficiaries and can be subject to Indian taxes (on behalf of the beneficiaries) at the maximum marginal rate i.e. 30%.

C. Revocable trust

Under the ITA, a transfer shall be deemed to be revocable if it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor or it 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. Thus, where a settlement is made in a manner that a settlor is entitled to recover the contributions over a specified period, and is entitled to the income from the contributions, the trust is disregarded for the purposes of tax, and the income thereof taxed as though it had directly arisen to the settlor. Alternatively, even in a situation where a settlor has the power to re-assume power over the assets of a trust, the trust is disregarded and the income is taxed in the hands of the settlor. In the case of a revocable trust, income shall be chargeable to tax only in the hands of the settlor. If there are joint settlors to a revocable trust, the income of the trust will be taxed in the hands of each settlor to the extent of assets settled by them in the trust. This arrangement is not specifically required to be recorded in a trust deed.

II. Public Trusts

Subject to conditions, income from property held in trust or other legal obligation, for a religious or charitable purpose is tax exempt.⁴

“Charitable purpose” as defined in S. 2(15) of the Income Tax Act includes relief of the poor, education, medical relief, Preservation of environment and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility.

However, the advancement of any other object of general public utility is not regarded as a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, unless: (i) such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and (ii) the aggregate receipts from such activity or activities during the relevant financial year do not exceed 20% of the total receipts.⁵

The above mentioned exemptions are allowed only to the trusts which are registered in accordance with the provisions given in the ITA.⁶ The ITA also provides certain grounds on which the exemption to the income of such trusts is not allowed.

4. ITA, Sec 11

5. ITA, Section 2(15)

6. ITA, Section 12A and Section 12AA

5. How to structure a Private Family Trust

I. Creation of the Trust

A trust may be created either through a non-testamentary document or by way of testamentary document like a Will. A trust intended to hold immovable property must be established by way of a duly registered trust deed, while a trust holding only movable property may be created either through a document (duly registered or not), or simply by an oral agreement along with delivery of the property to the trustee with the necessary instructions. Regardless of the mode of creation, four essential conditions are necessary to bring into being a valid trust.⁷

- The person who creates a trust (settlor) should make an unequivocal declaration of an intention on his part to create a trust. In order to create a trust, the settlor must properly manifest his intention by an external expression of it (by written or spoken words or by conduct) as opposed to an undisclosed intention.
- The settlor must clearly define and specify the objects. Since the purpose has to be accomplished by a trustee, who may not always be the author himself, it is necessary that the purpose is clearly declared so that the trustee can faithfully accomplish the author's purpose, for which the author has reposed confidence in the trustee.
- The settlor must specify the beneficiaries. Where there is no transfer of ownership, there is no trust.⁸ The settlor gives up the ownership of the property thus resulting in transfer of legal ownership of the property to the trustee and transfer of beneficial ownership to the beneficiaries of the trust.

The concept of ownership in the case of a trust is different under Indian and English Law. India does not recognize duality of ownership in the case of a trust, i.e. it recognizes only legal ownership and not equitable ownership as is provided for under

English law which recognizes duality of ownership i.e. legal and equitable. Under Indian law, the trustee is both the legal and beneficial owner of trust property.

- The settlor must transfer an identifiable property under irrevocable arrangement and totally divest himself of the ownership and the beneficial enjoyment of the income from the property.

Specifically with respect to a trust established by way of Will, it is important to note that such Will is not required to be registered even if the assets intended to be contributed are immovable properties. Further, the Will should be subject to the provisions of Indian Succession Act, 1925. One of the advantages of using a trust structure in your Will to distribute your assets instead of a direct distribution is that it results in a transmission of assets and not a transfer thereby resulting in various direct and indirect tax benefits

Since there is a transmission that takes place, stamp duty on property which would otherwise be payable (in case of a transfer) is not, which is another advantage.

II. Key Considerations

Once a decision has been made as to what type of private family trust (ie: discretionary / determinate, revocable / irrevocable), some of the key considerations with respect to structuring of the trust that should be kept in mind are discussed below.

A. Appointment of Trustee

A trustee has a fiduciary obligation under law to hold the trust Property for the benefit of the Beneficiaries to the trust. In doing so, the trustee is given various powers (as described below) under the trust deed to manage the affairs and Trust Property of the trust. Accordingly, it becomes important to choose the most suitable trustee for the commercial requirements of the family and the assets intended to be contributed to the trust. For example, a trustee may be an individual, either a trusted family advisor or a member of the family itself. The trustee may even be the Settlor or one of the

7. Trusts Act, Section 5

8. *Nadir Shaw v. Times of India*, AIR 1931 Bom 300

Beneficiaries of the trust so long as the individual acts only in his capacity as a trustee and fulfills his fiduciary obligations when managing the affairs of the trust. Alternatively, an institutional trustee may be favoured, especially in instances where neutral decision-making is a primary concern. The family may also consider setting up a Private Trust Company (“PTC”) with family members appointed as directors of the PTC to make decisions with respect to the trust. As a PTC is a separate legal entity under the Companies Act, 2013, any liability arising from the decisions of the board of directors of the PTC should be limited to the PTC and the directors should not be personally liable (unlike individual trustees) to the extent provided under law.

Important considerations to keep in mind when deciding whether to appoint an individual, institution, or PTC to act as trustee include:

- a. the level of control the family would like to maintain in day to day operations;
- b. neutrality of the trustee;
- c. objective and term of the trust;
- d. expertise with respect to the discharge of various fiduciary duties;
- e. knowledge / expertise with respect to various administrative functions like record keeping, legal disclosures, regulatory compliances, etc;
- f. annual costs.

B. Powers of Trustee

The powers of the trustee are captured in the trust deed. While the trustee’s powers can vary depending on the needs of the structure, generally a trustee has wide ranging powers that not only allow him to manage the daily operations of the trust and make distributions to Beneficiaries, but also empower him to amend the trust deed itself, add or remove Beneficiaries, make contributions to charities, or modify the term of the trust. In order to balance the powers of the trustee, the trust deed may provide for the appointment of a Protector. As discussed previously, the role of the Protector is purely advisory

in nature; however, by requiring that the trustee consult the Protector before making key decisions may help to ensure that the family’s best interests and the Settlor’s wishes are being followed.

Moreover, the Settlor may also provide the trustee with a Letter of Wishes (“LOW”), which outlines the considerations that the Settlor would like the trustee to keep in mind when making certain key decisions. Such key decisions may include determining the beneficial interest of each Beneficiary, making distributions, adding or removing Beneficiaries, etc. The LOW is a private document between the Settlor and the trustee, and while not legally binding, institutional trustees generally follow the guidelines set forth by the Settlor under the same.

While a single trustee may be appointed for the sake of efficiency and / or convenience, the trust structure may also provide for multiple trustees acting as co-trustees. The Trusts Act provides that if a trustee (i) deals with the trust-property as carefully as a man of ordinary prudence would deal with such property if it were his own;⁹ and (ii) takes all steps as would be reasonably requisite to preserve Trust Property¹⁰, then such trustee should not generally be liable for a breach of trust committed by his co-trustee provided that the trustee shall be liable if:

- a. he has delivered trust-property to his co-trustee without seeing to its proper application;
- b. he allows his co-trustee to receive trust-property and fails to make due enquiry as to the co-trustee’s dealings therewith, or allows him to retain it longer than the circumstances of the case reasonably require;
- c. he becomes aware of a breach of trust committed or intended by his co-trustee, and either actively conceals it or does not within a reasonable time take proper steps to protect the beneficiary’s interest.¹¹

In the event that multiple trustees are appointed to govern the trust, it becomes important for the trust

9. Trusts Act, Section 15

10. Trusts Act, Section 13

11. Trusts Act, Section 26

deed to provide a mechanism by which the trustees will make decisions. For example, in case of two trustees, decisions may be made only with the unanimous consent of both trustees, and in case of deadlock either status quo is to remain or a third independent individual (or Settlor) is to be chosen by the trustees to break the tie. In the case of three trustees decisions may be made by majority vote. Alternatively, the trust deed may provide that certain trustees are responsible for only specific matters. In certain instances (especially in the case of revocable trusts), the Settlor may be empowered to direct the trustees or have veto rights.

Further, the Trusts Act provides that a trustee may be discharged of his duties only by:

- a. the extinction of the trust
- b. the completion of his duties under the trust
- c. appointment under the Trusts Act of a new trustee in his place
- d. consent of himself and all the beneficiaries being competent to contract
- e. the court to which a petition for his discharge is presented; or
- f. whatever means provided under the trust deed.¹²

C. Dispute Resolution Mechanism

Last year, the Supreme Court (“SC”) of India, in *Vimal Shah & Ors. vs Jayesh Shah & Ors.*¹³, held that as beneficiaries are not signatories to a trust deed containing an arbitration clause, any disputes arising between beneficiaries or trustees of a trust cannot be referred to arbitration as such arbitration clause is not an “arbitration agreement” between the trustees inter se, between the beneficiaries inter se or between the trustees and the beneficiaries for the purposes of the Arbitration & Conciliation Act, 1996 (“**Arbitration Act**”). Furthermore, the SC clarified that even if the beneficiaries are considered to have accepted the trust deed vis-à-vis the settlor by accepting the benefits

thereunder, such acceptance does not imply that an arbitration agreement exists for the resolution of disputes between beneficiaries, trustees, or between trustees and beneficiaries.

It was further held that all disputes arising out of a trust deed and the Trusts Act are not arbitrable in India. The SC analyzed the scheme of the trust act finding that it comprehensively and adequately covers each subject pertaining to trust law, right from the creation of the trust and extending to management of the trust as well as provisions relating to beneficiaries and trustees, including remedies available to get grievances settled. Specifically on the point of legal remedies, the SC observed that the trust act provides specifically for the resolution of various disputes and confers jurisdiction for the same on Civil Courts. The SC referred to the principle of interpretation that where a specific remedy is prescribed by statute, the person facing such a grievance is denied of any other remedy. Therefore, the SC concluded that the presence of provisions in the trust act specifically dealing with the forum for dispute resolution reflects the intention of the legislature to impliedly bar arbitration of such disputes. That being said, provisions for alternative dispute resolutions mechanisms like conciliation as governed by the Arbitration Act or mediation may still be provided for under the trust deed.

D. Trusts with cross-border elements

With the number of HNW families having members residing in various countries, the likelihood that a trust structure will have cross-border elements is increasing. Keeping in mind that the Reserve Bank of India has strict rules with respect to foreign exchange and the cross-border transfer of funds / immovable property, it becomes important to consider the residency status of the Settlor, Trustee and Beneficiaries of a trust.

For example, an Indian resident Settlor may set up a trust outside of India (“**Offshore Trust**”). In fact, the Foreign Exchange Management Act, 1999 (“**FEMA**”) of India has granted general permission to a person resident in India to hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such ‘Foreign

¹². Trusts Act, Section 71

¹³. Civil Appeal No. 8164 of 2016

Currency Assets' have been acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. Such person may set up a trust in such jurisdiction or any other jurisdiction to which he could contribute the Foreign Currency Assets. However, remitting Indian funds to such Offshore Trust should be subject to India's Liberalised Remittance Scheme ("LRS"), under which resident individuals are allowed to transfer up to USD 250,000 per person per financial year for permitted current and capital account transactions without prior RBI approval. These transactions include acquisition of immovable property shares or any other assets outside of India Funds transferred through LRS may even be used to set up a foreign company. Further, taxation of such Offshore Trust should be subject to the tax laws of the foreign jurisdiction. From an Indian tax perspective, income of the Offshore Trust should be taxable in India only if all its beneficiaries are Indian residents, or the assets of the trust are located in India.

An Indian resident Settlor may also settle a trust in India for the benefit of both resident and NRI beneficiaries. Distributions to such beneficiaries

should not require prior RBI approval; however Indian exchange control laws do not permit direct distributions to be made to NRI's offshore account. In such event, an NRI may open an NRO account with an authorized dealer bank, and distributions by the trust should be permitted to such account.

Further, while the Trusts Act does not bar a non-resident from acting as a trustee to an Indian Trust, it does require that provide that where a trustee is absent from India for a continuous period of six months or leaves India with the intention of residing abroad, then a new trustee may be appointed in his place.¹⁴ That being said, the Trusts Act also required that a trustee be able to hold property.¹⁵ Considering that Indian foreign exchange laws do not permit non-residents to directly hold immovable property, the trustee of a trust having immovable property would not be legally capable of holding such property on behalf of the trust and would therefore not be competent to act as trustee. Moreover, in the event that a trustee is non-resident, the trust should not be engaged in activities prohibited for non-residents under India's foreign exchange regulations.

14. Trusts Act, Section 73

15. Trusts Act, Section 10

About NDA

Nishith Desai Associates (NDA) is a research based international law firm with offices in Mumbai, Bangalore, Palo Alto (Silicon Valley), Singapore, New Delhi, Munich and New York. We provide strategic legal, regulatory, and tax advice coupled with industry expertise in an integrated manner.

As a firm of specialists, we work with select clients in select verticals on very complex and innovative transactions and disputes.

Our forte includes innovation and strategic advice in futuristic areas of law such as those relating to Bitcoins (block chain), Internet of Things (IOT), Aviation, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Med-Tech, Ed-Tech and Medical Devices and Nanotechnology.

We specialize in Globalization, International Tax, Fund Formation, Corporate & M&A, Private Equity & Venture Capital, Intellectual Property, International Litigation and Dispute Resolution; Employment and HR, Intellectual Property, International Commercial Law and Private Client. Our industry expertise spans Automobile, Funds, Financial Services, IT and Telecom, Pharma and Healthcare, Media and Entertainment, Real Estate, Infrastructure and Education. Our key clientele comprise marquee Fortune 500 corporations.

Our ability to innovate is endorsed through the numerous accolades gained over the years and we are also commended by industry peers for our inventive excellence that inspires others.

NDA was ranked the ‘Most Innovative Asia Pacific Law Firm in 2016’ by the *Financial Times - RSG Consulting Group* in its prestigious FT Innovative Lawyers Asia-Pacific 2016 Awards. While this recognition marks NDA’s ingress as an innovator among the globe’s best law firms, NDA has previously won the award for the ‘Most Innovative Indian Law Firm’ for two consecutive years in 2014 and 2015.

As a research-centric firm, we strongly believe in constant knowledge expansion enabled through our dynamic Knowledge Management (‘KM’) and Continuing Education (‘CE’) programs. Our constant output through Webinars, Nishith.TV and ‘Hotlines’ also serves as effective platforms for cross pollination of ideas and latest trends.

Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has been developed into a global case study and published by John Wiley & Sons, USA in a feature titled ‘Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage’ in the September 2009 issue of *Global Business and Organizational Excellence (GBOE)*.

A brief below chronicles our firm’s global acclaim for its achievements and prowess through the years.

- IDEX Legal Awards: In 2015, NDA won the “M&A Deal of the year”, “Best Dispute Management lawyer”, “Best Use of Innovation and Technology in a law firm” and “Best Dispute Management Firm <<http://idexlegalawards.in/ArticlePage.aspx?aid=6>>”. Nishith Desai was also recognized as the ‘Managing Partner of the Year’ in 2014.
- Merger Market: has recognized NDA as the fastest growing M&A law firm in India for the year 2015.
- Legal 500 has ranked us in tier 1 for Investment Funds, Tax and Technology-Media-Telecom (TMT) practices (2011, 2012, 2013, 2014, 2017)

- International Financial Law Review (a Euromoney publication) in its IFLR1000 has placed Nishith Desai Associates in Tier 1 for Private Equity (2014, 2017). For three consecutive years, IFLR recognized us as the Indian “Firm of the Year” (2010-2013) for our Technology - Media - Telecom (TMT) practice.
- Chambers and Partners has ranked us # 1 for Tax and Technology-Media-Telecom (2014, 2015, 2017); #1 in Employment Law (2015 & 2017); # 1 in Tax, TMT and Private Equity (2013, 2017); and # 1 for Tax, TMT and Real Estate – FDI (2011).
- India Business Law Journal (IBLJ) has awarded Nishith Desai Associates for Private Equity, Structured Finance & Securitization, TMT, and Taxation in 2015 & 2014; for Employment Law in 2015
- Legal Era recognized Nishith Desai Associates as the Best Tax Law Firm of the Year (2013).

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Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our "Hotlines". These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction.

We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

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As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports.

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