

A group of business professionals are silhouetted against a bright sunset or sunrise window. They are seated around a long table, engaged in a meeting. The scene is reflected on a glossy floor. The overall mood is professional and collaborative.

Wealth succession planning

Succession planning - overview

What is Succession / Estate planning?

- ▶ Building a robust structure in conformity with applicable succession laws for
 - ▶ Perpetuating / preserving/ maintaining/ holding the family wealth for generations
 - ▶ Flexibility to distribute economic interests in desired proportions to family members and at desired time
 - ▶ Regular income flow for family members

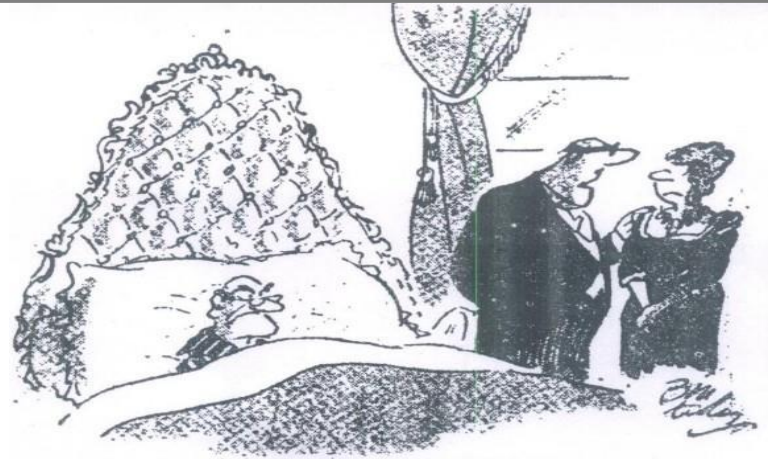
What is achieved by Succession / Estate planning?

- ▶ Smooth transition of wealth to the next generation
- ▶ Segregation of economic interest and management control
- ▶ Segregation of business and personal assets
- ▶ Inheritance tax planning (if levied in future)
- ▶ Simplification of group structure goes hand in hand with estate planning facilitating liquidity to Promoters
- ▶ Addressing limitations if any under forced heirship rules

Estate duty (ED) - Typical features

- ▶ *When attracted?*
 - ▶ On demise of an individual
- ▶ *Country having right to levy?*
 - ▶ World wide estate chargeable in country of citizenship/ residence/ domicile of individual
 - ▶ Additionally, country in which assets are located may also charge ED on such assets
- ▶ *Levied on?*
 - ▶ Value of Net Estate passing on the individual's death
- ▶ *Value?*
 - ▶ Fair market value of assets taken as basis for levy of ED
- ▶ *Rate?*
 - ▶ Rates of ED generally progressive
 - ▶ Range from 7.5% to 40%
- ▶ *Standard deductions & Exemptions?*
 - ▶ Estate up to a certain threshold level not taxed – typically not a very high threshold
 - ▶ Very few exemptions available (e.g. one residential house, etc)

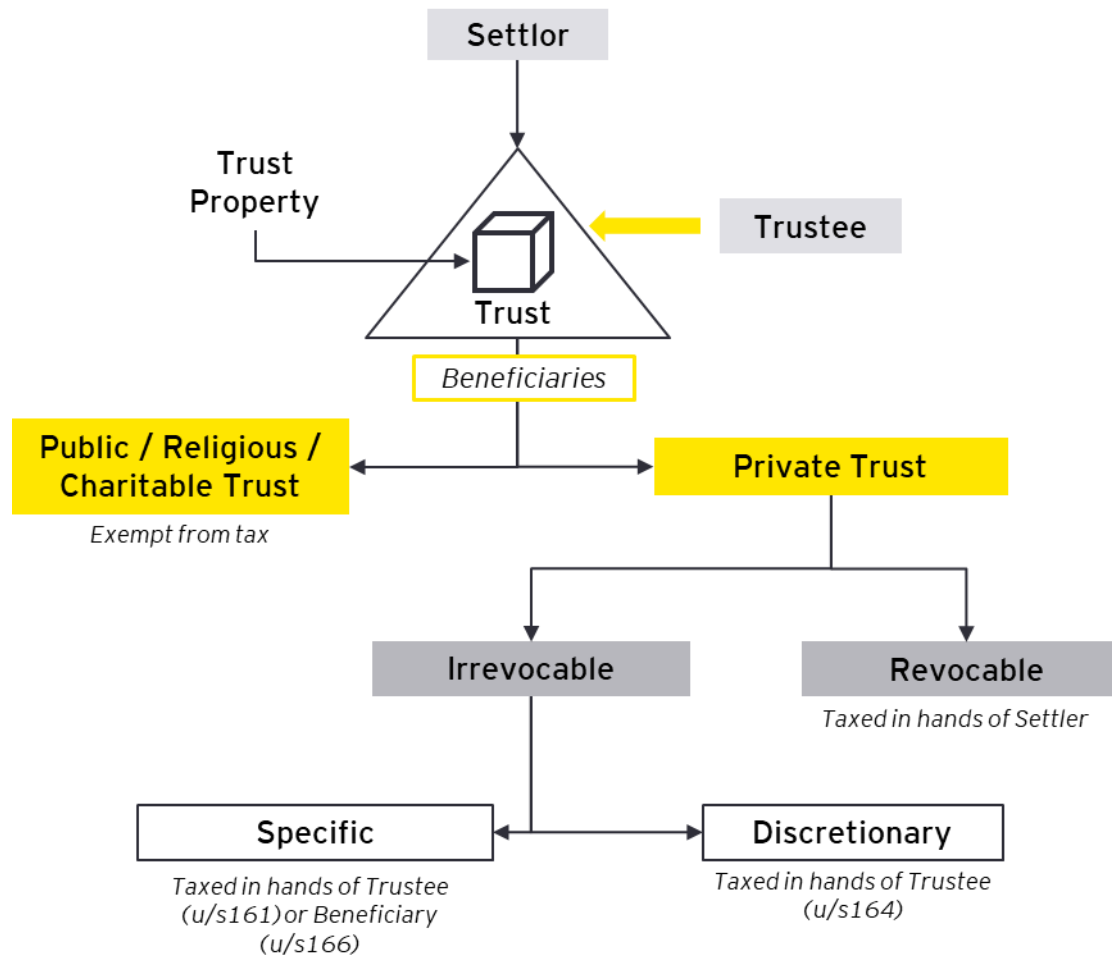
- ▶ *Anti abuse accompaniments?*
 - ▶ ED generally supplemented by gift tax levy on transfer during lifetime
 - ▶ Gifts made within specific time period prior to death of the individual included within ambit of ED
- ▶ *International Scenario*
 - ▶ ED – Currently prevalent in USA, UK, RSA, Brazil, etc
 - ▶ Variation of ED i.e. Inheritance tax – exists in Japan, Germany, Netherlands, Belgium, etc
 - ▶ No ED in Russia, China, India, etc



"I'm afraid it's only Death Duty that's keeping him alive."

Trust - Concept

Diagrammatic Representation



Trust - Concept

- ▶ A legal concept
- ▶ Property vested / placed under control of a person or persons
- ▶ For benefit of specified individuals or organizations
- ▶ Governed by Trust Deed
- ▶ Trustee holds legal title to trust property but bound by fiduciary duty to exercise legal control for benefit of beneficiaries
- ▶ Beneficiary of the trust holds the beneficial or equitable title

Discretionary Trust

- ▶ Trustee has absolute discretion to apply the income and capital of the trust.
- ▶ Beneficiaries, as a result of trustee's discretion, are not entitled to receive definite proportion of income or corpus.

Specific

- ▶ Share of each beneficiary is pre-determined at the time of formation.

Settlor

Person who places his property or settles his property into the trust for the benefit of other specified individual / individuals.

Trustee

Person in whose confidence the property is placed for the benefit of specified individual / individuals.

Trust property

The subject matter of the trust which is applied for the benefit of the beneficiaries.

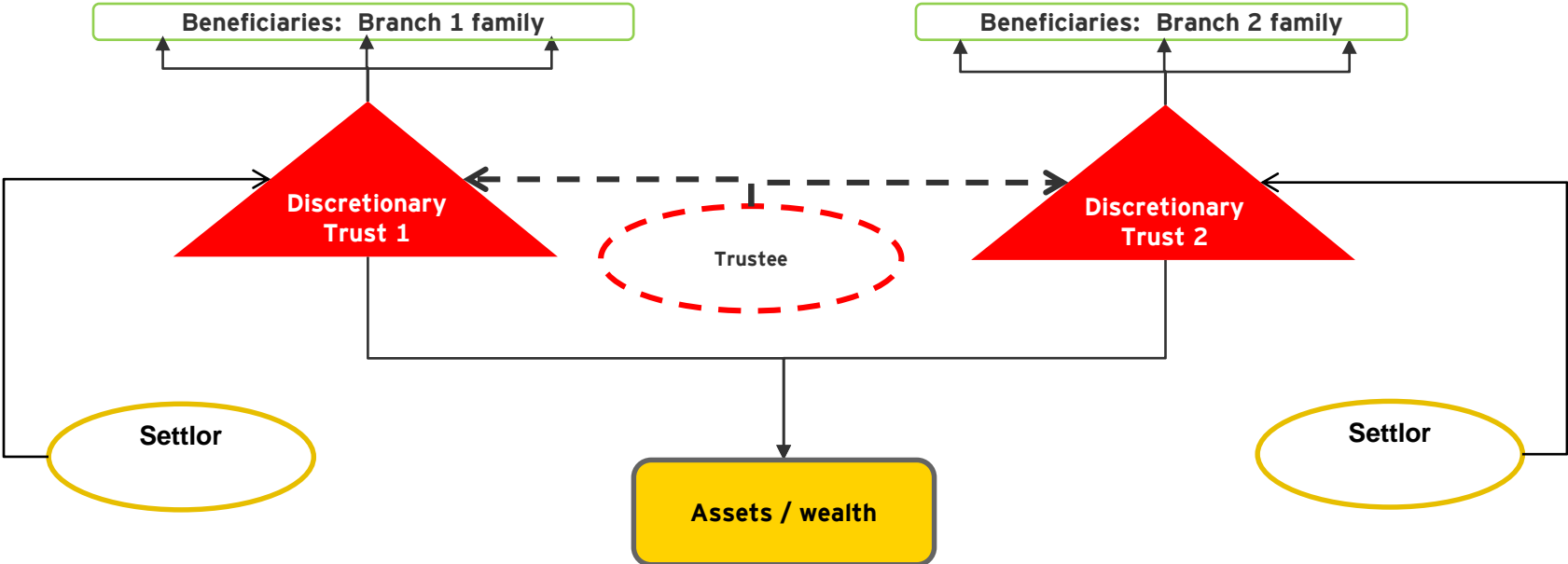
Trust Deed

Instrument (usually written) governing the trust - should state clearly objectives of settling the trust.

Beneficiaries

Individuals for whose benefit the property is settled.

Family Trust - typical structure



Trust v/s Will

Trust	Will
Setting up of trust involves transfer of property	No transfer of property involved
Legal ownership transferred to trustees	No transfer of ownership to any person till testator's death
Role of Settlor, trustee and beneficiary can be played by identified person	Properties passed on through Will which is effective only after death of Testator
Trust can be revoked only if there is a power contained in trust deed	Will can always be revoked during lifetime of Testator
Vesting of assets in trust while the settlor is alive	Litigation prone – need to obtain probate
Trust is more expensive Trust is useless unless it is funded	Inexpensive
Once executed cannot be altered unless Trust Deed provides otherwise	Can be changed as per the discretion of the testator at any point of time
Property left through a trust does not go through probate	Property left through Will goes through probate
Privacy after death	Will becomes a public document upon death of the testator
Can be used to overcome forced heirs rules	NA
Stamp duty on transfer of property to trust	No stamp duty exposure on receiving the property through Will

Status of a trust

- ▶ Vexed issue
- ▶ Not apt to be equated to company, firm / LLP or HUF
- ▶ Why not AOP / BOI ?
- ▶ Can it be individual ?
- ▶ For residential status who should be looked at
 - ▶ Settlor
 - ▶ Beneficiaries
 - ▶ Trustees

Taxation on settlement

For settlor / donor

Sec 47(iii) of the IT Act - '**any transfer of a capital asset under a gift or will or an irrevocable trust**'

For recipient Trust

Sec 56(2) of the IT Act - '**where any person receives, in any previous year, from any person or persons.....**

- (a) any sum of money, without consideration....
- (b) any immovable property..
- (c) any property, other than immovable property..

Provided that this clause shall not apply to any sum of money or any property received—

(I) from any relative....

.....

(II) under a will or by way of inheritance...

.....

(X) from an individual by a trust created or established solely for the benefit of relative of the individual

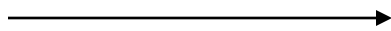
Taxation on settlement

***Explanation.*—For the purposes of this clause, "relative" means—**

- (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);**

Case study 1

Mr A - Uncle

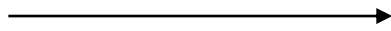


Mr B - Nephew



Whether direct gift exempt ?

Mr A - Uncle



Mr B - Nephew



Trust for benefit of Mr B and his family

Whether exempt ?

Taxation of Trusts

Particulars	Specific Trust	Discretionary Trust
Nature	<ul style="list-style-type: none"> ▶ Specific trust is a trust where the interest of beneficiaries are specified in the trust deed 	<ul style="list-style-type: none"> ▶ Discretionary trust is one where the interest of beneficiaries are not specified in the trust deed but depends on the discretion of the trustee
Tax on income earned and distributed	<ul style="list-style-type: none"> ▶ Income earned during a year shall be taxed in the hands of Trustee (as RA of Trust) or in the hands of beneficiaries to the extent of their share (at the option of the tax officer) 	<ul style="list-style-type: none"> ▶ Income earned and distributed during the same year ought to be taxed in the hands of Trustee (as RA of Trust) or in the hands of the recipient beneficiaries to the extent of receipt of such income
Tax on income earned but not distributed		<ul style="list-style-type: none"> ▶ In case the income is earned but distributed in subsequent years, the income gets taxed and assessed only in the hands of Trustee (as RA of Trust) in the year of earning such income ▶ Subsequent distribution of income is arguably distribution of capital sum and hence does not constitute ordinary income in the hands of the beneficiary
Distribution of past income	<ul style="list-style-type: none"> ▶ Argument can be taken that distribution of past income is a capital receipt ▶ Provisions of <u>Section 56(2)(x)</u> may not apply if the beneficiaries qualify as relatives as defined under Section 56(2)(vii) 	
Distribution out of corpus	<ul style="list-style-type: none"> ▶ May not be taxable in the hands of the beneficiaries on the following arguments: <ul style="list-style-type: none"> ▶ Beneficiaries are the owners of trust fund: distribution entails release from pool of funds which otherwise belong to beneficiaries. Trustee are custodians holding trust fund in a fiduciary position ▶ Provisions of Section 56(2)(x) may not apply if the beneficiaries qualify as relatives and considering that it is not without consideration' 	

Taxation of Trusts

Particulars	Specific Trust	Discretionary Trust
Trust earns business income	<ul style="list-style-type: none"> ▶ <u>Only business income</u> - The whole of the income of the trust is taxable at MMR ▶ <u>Other income vs. Business income</u> - Interplay between other income (dividend and capital gains) taxable at specific rate vis-à-vis taxable @MMR 	
Assessment of trust	<ul style="list-style-type: none"> ▶ As many as there are number of beneficiaries ▶ Though for administrative convenience trustees may submit only one ITR on consolidated basis and ITO may pass only one assessment order 	<ul style="list-style-type: none"> ▶ Typically as one unit

Other key aspects

- ▶ Trust and FEMA aspects
 - ▶ Trust is resident or non-resident
 - ▶ Settlement of Trust by R for benefit of NR
 - ▶ Limits for repatriation of current income vs non-current income

- ▶ Whether a Trust can act as a partner in a PF / LLP?

- ▶ SEBI Takeover Code aspect when Listed Co shares are transferred to trust

- ▶ Significant Beneficial Ownership disclosure

- ▶ Trust Act key sections eg Sec 56 (Right of specific execution), Sec 58 (Right to transfer beneficial interest)

Trust deeds

- ▶ Nature of the trust - Specific or discretionary, irrevocable, etc.
- ▶ Purpose of the trust
- ▶ Tenure of the trust - Vague / open ended ?
 - ▶ Law against perpetuity (S 114 of ISA)
- ▶ Corpus of the trust
- ▶ Power of the trustee - To add / remove beneficiaries
- ▶ Succession of trusteeship
- ▶ Income and corpus distribution
- ▶ Amendment to trust deed

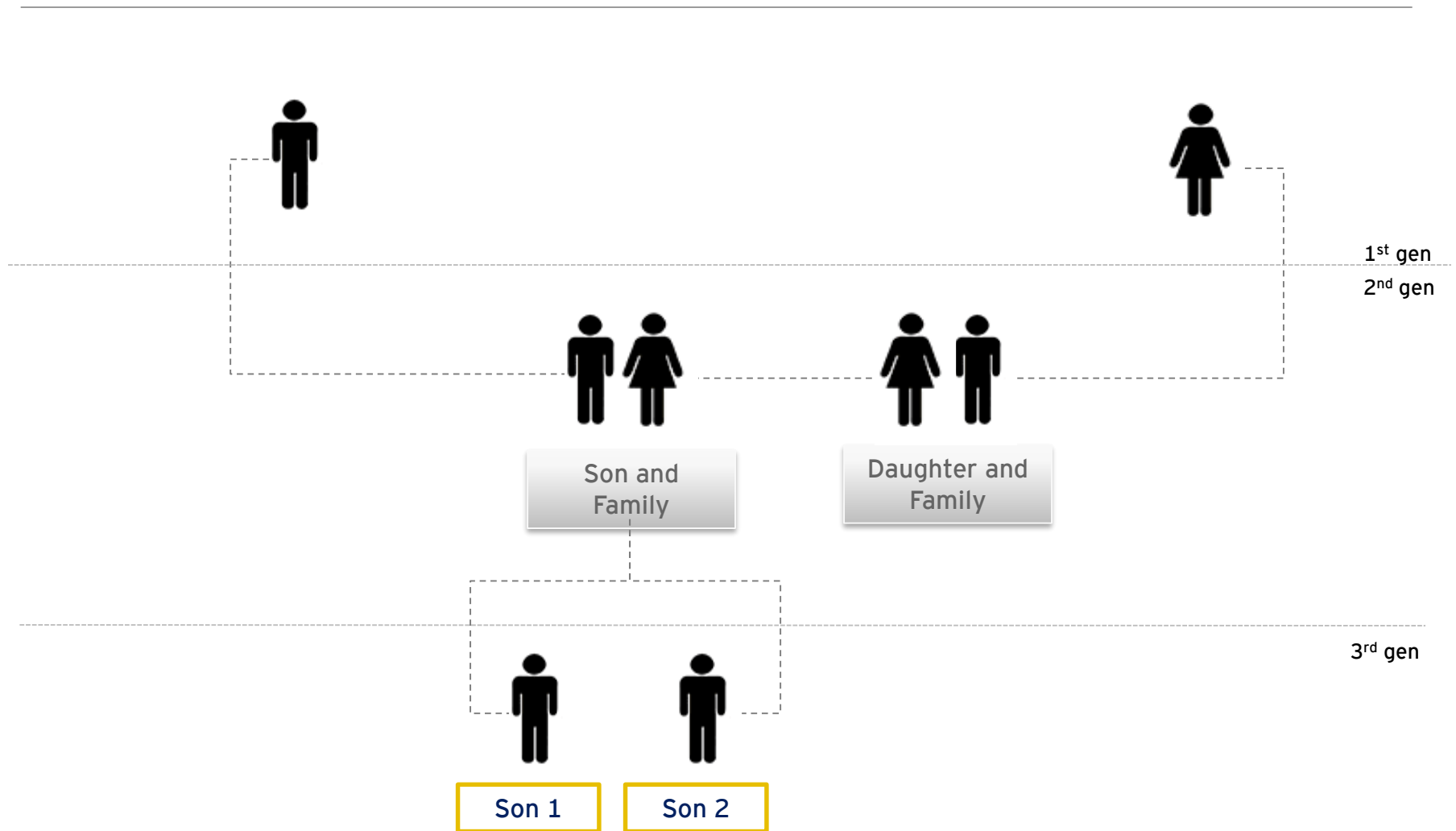
Family Constitution / Family Charter

Family Constitution / Family Charter - Concept and benefits

- ▶ Written document recording the consensus that has been reached on the principles and policies that should be followed by the family in the Business, and in their inter se dealings
- ▶ By adopting Family Charter, the family members acknowledge that it is legally binding and enforceable
- ▶ Aids and improves communication between the family and record what has been agreed about matters such as:
 - ▶ Family's long-term goals for the Business / Group;
 - ▶ Relationship between the Family and the Businesses;
 - ▶ Transfer of ownership interest in the businesses;
 - ▶ Distribution of income, proceeds and assets of the businesses;
 - ▶ Recruitment, engagement and appointment of family members as key employees and managing directors in the businesses;
 - ▶ Dispute resolution mechanism;
 - ▶ Rules and procedures in relation to exit
 - ▶ Shareholder rights - tag along, drag along, ROFR
 - ▶ Mandatory dividend declaration
 - ▶ Use of brand belonging to the family

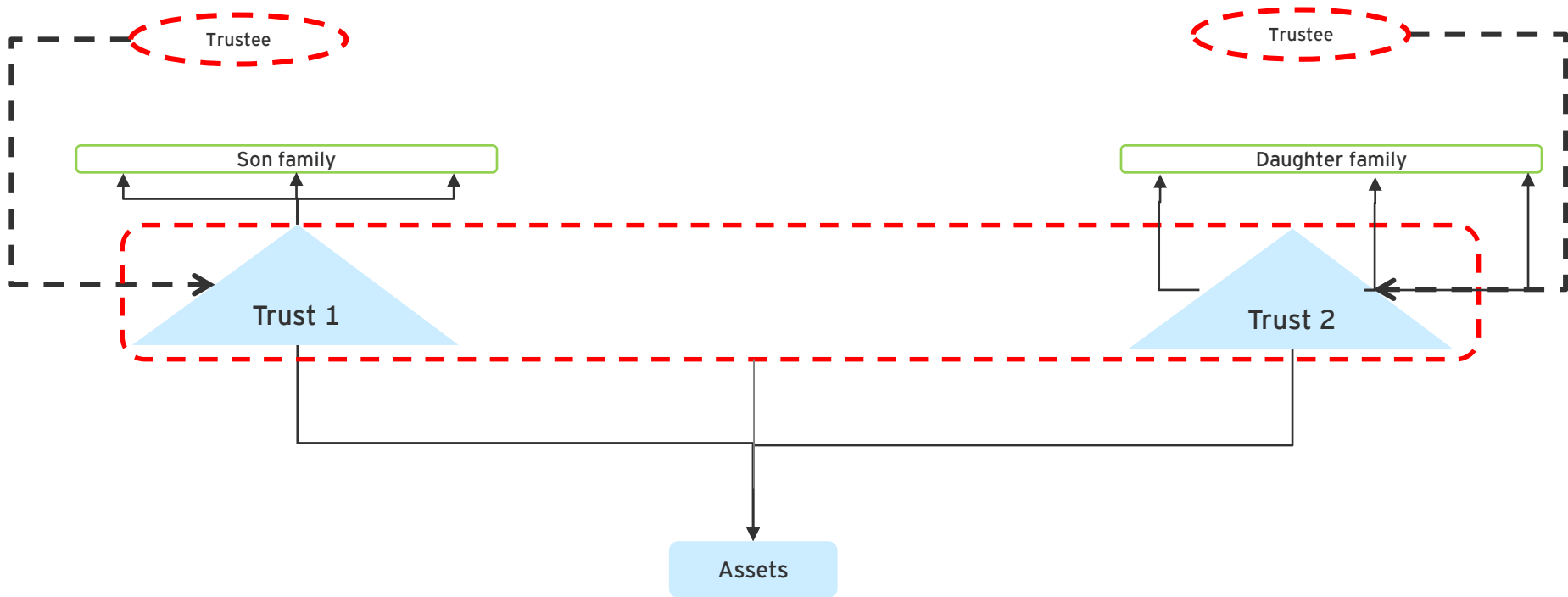
Case Study 2

Forced heirship rules



Case Study 2

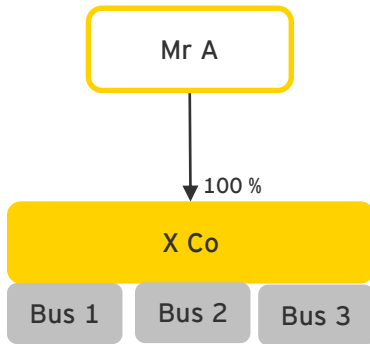
Main objective - Equal distribution of wealth to all second generation members



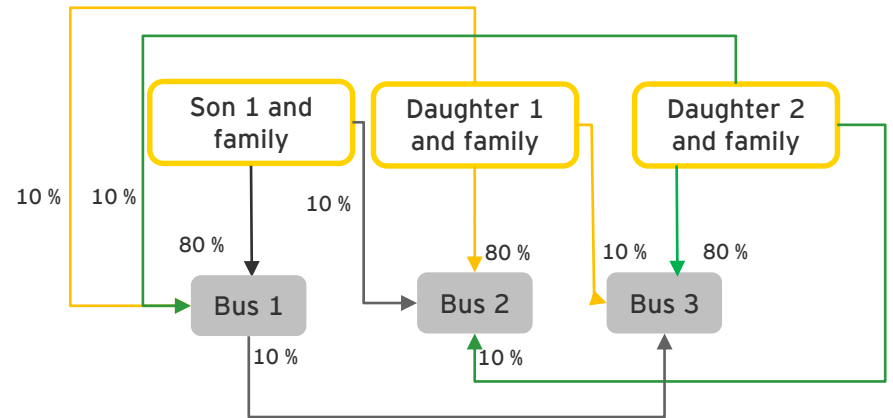
Case Study 3

Group re-structuring

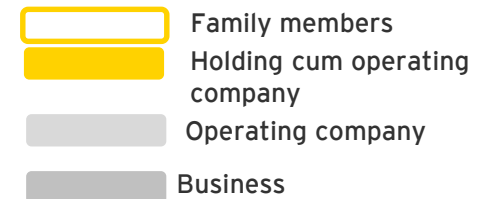
Present Structure



Proposed objective



- ▶ Business 1 will be controlled by Son1 and his family
- ▶ Business 2 will be controlled by Daughter 1 and family
- ▶ Business 3 will be controlled by Daughter 2 and family



Case Study 3

Main objective - Segregation of businesses housed in one company to multiple operating companies and specific business to be controlled by identified family member

