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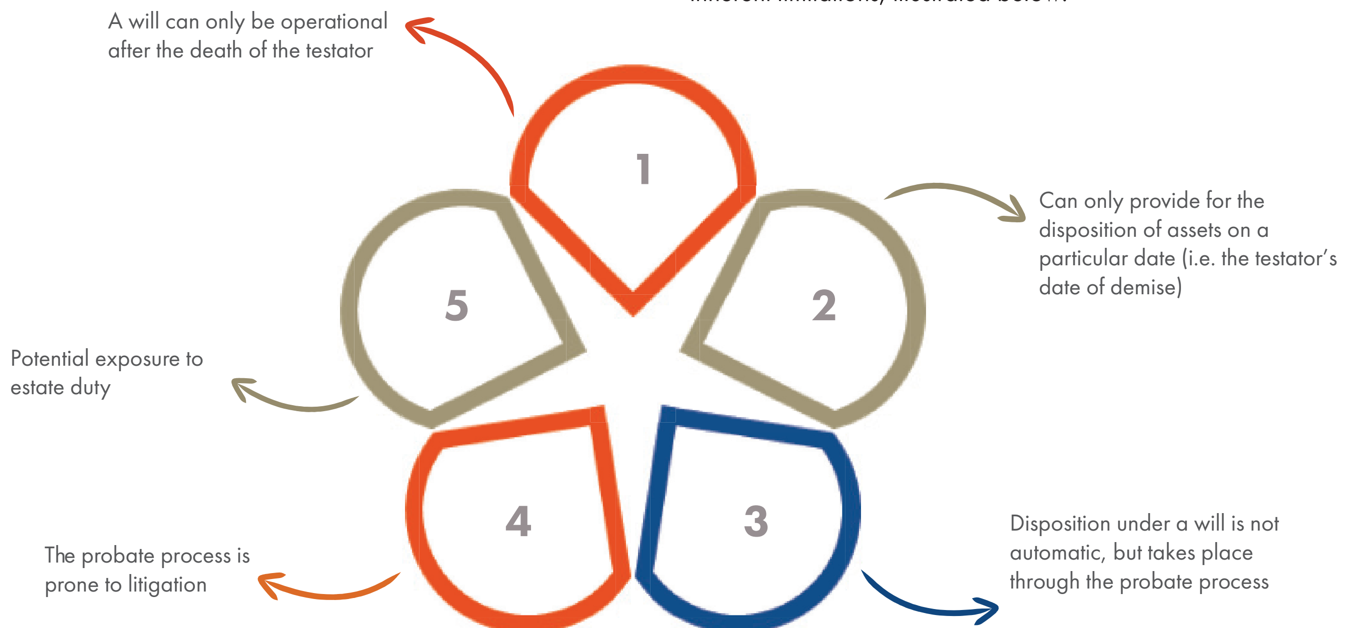
Trust – Succession, Inheritance and Family Settlements

The biggest challenge being faced by Indian promoter families is that of succession. In contrast to a professionally managed enterprise, where succession is more a matter of a meritocracy, a wide spectrum of interpersonal issues come into play in the case of family-run businesses. More typically in the case of businesses that are run by Indian families, it is not uncommon for the business to be passed on to the following generations, with the result that individuals with different ideologies and varied visions are obligated to manage the business cohesively. Furthermore, these individuals also have to deal with pressures to perform, inter-generational frictions, family discord finding their way into business decisions, as well as unclear division of functions, authority, and accountabilities.

A well-planned structure, which can ease the issues surrounding family succession, is therefore the need of the hour. It is also important to lay down a clear succession plan for the family wealth, in order to ensure that such wealth is protected, preserved, and passed on to future generations in the intended manner.

Traditionally, a will has been generally employed as a means of managing succession issues. In common parlance, a will is a legal declaration of a person's (the testator's) wishes regarding the disposal of his or her property after death. A will can be amended as many times as desired and, per the law, the most recent will of the testator prevails. Furthermore, the transfer of property under a will does not attract stamp duty. However, a will also has certain inherent limitations, illustrated below:

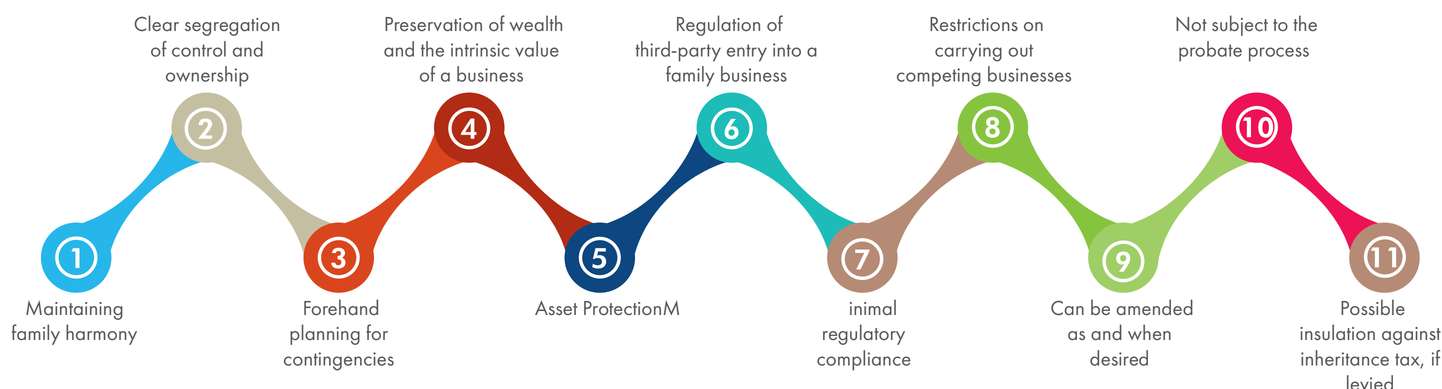


Giving due consideration to above limitations of wills, more and more families are now adopting a family trust structure for their succession and estate planning, since such trusts help to mitigate the shortcomings of a will considerably. A private family trust offers a lot of flexibility and ease for effective control and management and facilitates smooth transfer of wealth over generations. Its importance is further amplified given the anticipated re-introduction of inheritance tax, and the possible insulation that a private trust may extend against a will, where the exposure is certain.

A trust structure provides the opportunity for the promoters to pre-empt all possible scenarios, and to document the same in an orderly manner, in order to avoid potential family disputes thereby enabling efficient operation of the family business. It can help to strengthen family bonds by reducing any uncertainty about the

roles of family members and by expressly stipulating what is expected of them. It can thereby help to create an enduring family legacy, by keeping intact the predecessors' vision of the family business, although not at the expense of the dynamism and the adaptability that will be necessary for any required changes. A trust structure can also create a structured format for a family office and enable efficiency in

Benefits of trust structure



the management and running of the office. Private trusts in India are governed by the Indian Trusts Act, 1882. The trust law is archaic, but considering the ease and flexibility that a trust offers for planning an effective succession, more and more business families are now migrating their businesses and family wealth under a trust structure.

In a strict legal sense, a trust is not a separate legal entity, unlike a company. It is more akin to a legal arrangement that is made between the author of the trust and the trustee for the benefit of the beneficiary. A trust typically involves three parties – the settlor, who is also known as the author of the trust, the trustee, and the beneficiary. A trust is created when the settlor hands over any property to the trustee, which is to be used and employed for the benefit of the beneficiary. This legal arrangement is codified by means of a trust deed. Thus, the trust deed becomes a document of prime importance, since it lays out the essential framework for the governance, control, and management of family businesses and wealth across generations. It therefore needs to be drafted with utmost care and caution.

When setting out the succession policy for a family business, two factors need to be considered: first, the legal conduct and relationship between the trustees and beneficiaries; second, the softer aspect of human behavior. Many families also develop a separate family charter along with a trust deed, providing guidance on intricate facets of joint family arrangements, viz. spending guidance, directions regarding the routine conduct of family members, behavioural expectations, etc. However, such aspects can also be very well stipulated under a singular trust document.

Trusts can take various forms. To begin with, one needs to confirm whether a trust is desired to be a revocable trust or an irrevocable trust. A revocable trust can be revoked (cancelled) at any time by its settlor, while an irrevocable trust will continue until the term of the trust expires. The tax and regulatory implications of revocable and irrevocable trusts vary, meaning that such a determination becomes important. Furthermore, one needs to ascertain whether the desired trust is to be a specific trust, with the shares of the beneficiaries being fixed, or whether a discretionary trust would better serve the purpose. A discretionary trust is a trust that involves the beneficiaries being identified, although their beneficial interest in the trust is not ascertained upfront. A trust may also be formed as a discretionary trust that becomes specific upon the occurrence of a trigger event. Take the case of a family with a father and three children, for instance: although the trust is set up as a discretionary trust, with the father as a the trustee, the same trust can be made specific, with the shares of the children being fixed, upon the death of the father. Furthermore, a trust can also be created for a specific purpose or for specific assets. There has also been a rise in the creation of offshore trusts by high net-worth individuals to house their overseas assets, for better succession as well as the potential mitigation of estate taxes.

There are no formal rules regarding the format or the contents of the trust deed. Although the contents will vary from family to family, depending upon the family's philosophy, its social and business

ideologies, and the relations between the members of the family, the following points will need to be considered:

1. Defining Trustee Lineage – this is important so that structure continues even when the original trustee cease to exist
2. Delegation of authority and the decision-making matrix – to provide for matters that are to be decided by majority / unanimous consent of the trustees
3. Policy for the distribution of the corpus and the income from the trust
4. Providing veto powers to identified trustee for specific decisions
5. Providing directions with respect to non-compete clauses, exit conditionalities
6. Providing distributions and support policies in the event of specific circumstances such as marriages, deaths, divorces etc.
7. Safeguarding the interest of specific family members, for instance a spouse (after the demise of the head of the family)
8. Specific policies regarding the discipline and behaviour of the next generation.
9. Allocation of a certain portion of wealth for philanthropic purposes

Many times, the concept of a protector is included in a trust deed. A protector is a person who is appointed to supervise the trustees, and who would normally step in when the affairs of the trust are not being run in accordance with the mandate provided by the trust deed. Whether a family advisory council should be appointed under the trust deed, to guide inexperienced trustees, also needs to be considered.

Although the trust structure extends significant benefits and is a favoured choice for smooth succession planning and potential estate tax protection, due consideration must also be given to tax and regulatory nuances when conceptualizing a private trust structure, for its effective and efficient functioning.

There are specific provisions under the Indian income-tax act that deal with the taxability of the income that is earned by a trust. A private trust is usually formed following a contribution of funds or property from one of the family members, which is to be used for the benefit of the larger family. A private trust does not require registration, unless it is formed through the settlement of immovable property. Where a settlor, being a family member, makes an irrevocable settlement to the trust, no tax implications arise for any of the trust parties. In fact, it has been now clarified that any contribution from a family member to a trust that has been created for the benefit of such family member's relatives will not attract any tax implications. The income that is earned by the trust, however, will be taxed and assessed, depending on whether the trust is a specific or a discretionary trust. In the event that it is a specific trust, where the share of each beneficiary is fixed and known, and in the absence of any business income, the tax liability is in the like manner and to the same extent as the tax that would have been leviable upon and recoverable from the beneficiaries on an individual basis. Such income can be assessed either in the hands of the trustee or in the hands of individual beneficiaries. In the event that it is a discretionary trust, where the shares of each beneficiary have not been determined, the income of the trust is taxed at the maximum marginal rate, subject to any lower special rates of tax, as in the case of capital gains. However, following the discharge of the tax liability, the subsequent distributions to the beneficiaries are tax-free. As such, no double taxation occurs under a trust structure.

One also needs to consider the tax costs on the migration of assets to the trust. Any contribution of property from a family member to a trust that has been created for the benefit of his relatives is generally tax exempt. Furthermore, any distributions of assets or income from the trust to its beneficiaries under a private family trust will not generally attract any tax liability - either in the interim period or at the time of the dissolution of the trust. However, it is important that the structure of the trust and the drafting of the deed is robust, so that such exemptions cannot be challenged.

In addition to such tax considerations, regulatory implications are also pertinent. For instance, where the assets that are to be housed under the private trust are shares in a listed company, the provisions of the SEBI Takeover Code become imperative. Furthermore, the transfer of immovable properties to a trust may also attract stamp duty, as per the applicable state laws, and therefore the cost of such a transfer needs to be taken into consideration if such a property is to be transferred through a will to the desired trust. In the event that a family member is a non-resident, exchange control regulations also need to be considered. Where it is proposed that non-residents are to be the beneficiaries, the prior approval of Reserve Bank of India is recommended, in the absence of any specific permissions or restrictions under Indian exchange control regulations. Also, any distribution of funds from the trust to non-resident beneficiaries needs to be compliant with the exchange control regulations or, in certain cases, an express approval of RBI should be sought. Furthermore, where a non-resident individual becomes a trustee of a trust, regulatory adherence, as well as considerations regarding the tax residency of the trust, will need deeper analysis.

As is evident, finalising a trust document requires a profound forethought to ensure smooth and seamless transition of a family's wealth and business over generations, without frustrating the individual desires and wishes of the family members. Such a document needs to be tax-efficient and compliant with the regulatory scenario. It is also important to ensure that the deed offers enough flexibility to adapt to the ever-changing socio-economic and business circumstances. Above all, however, it needs to be simple to understand, so that it can be effectively implemented, and so that its mettle is not lost amongst legal verbiages and uncertainties which accompanies the passage of time and advancement of technology.

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