



Managing investor's money under 'trust structure' is not liable for service tax

M/s ICICI Econet Internet and Technology Fund & Ors. v. The Commissioner of Central Tax, Bangalore & Ors¹

Karnataka High Court ('the Court') allowing a batch of several appeals against the Tribunal (CESTAT) ruling, held that a trust structure is not liable for Service Tax, when it deals with monies collected as an investment fund. The Court held that Venture Capital Fund (trust) and its Investors ('contributors') cannot be regarded as separate entities and applying the doctrine of mutuality, no person can serve himself/herself, for which reasons there is no service that could be taxed.

Facts of the case

- India Advantage Fund III etc all are Venture Capital Trusts ('the Petitioner'/'trust') established under the Indian Trust Act, 1882. Contributors contribute money to the trust fund, which is managed by Investment Managers.
- On the back of an investigation by the Anti-Evasion Unit, it was proposed that the trusts were liable to pay Service Tax on the retained portion of monies distributable to the contributors – such retention was regarded as service charges/fee for managing the assets of the trust. A show cause notice was issued to the Appellant proposing to demand

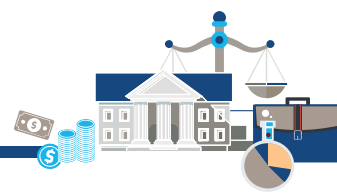
service tax on 'expenses incurred by the assessee' and 'the amount paid to Class C investors as return on investment.

- The matter travelled to the Tribunal, who confirmed the demand and held that a trust is a person for the purposes of the law of Service Tax. The Tribunal held that 'carried interest' is neither interest nor return on investment, but a portion of the consideration retained by the taxpayer for the services rendered to the investors and passed on, in the disguise of return on investments, to Class C unit holders, i.e. the Investment Manager.
- The Tribunal also held that the trust has violated the principles of mutuality by concerning themselves in commercial activity and the services provided by the Trust amounts to asset management services which falls under the taxable service category of banking & other financial services. The trusts / funds appealed this decision to the High Court.

Appellant's Contention

- The trust is a pass-through entity and does not provide services, and so, Service Tax is not leviable on the retained portion, for the following reasons:
 - The trust does not qualify as a 'person'.

¹ TS-52-HC-2024(KAR)-ST



- Activities undertaken by a trust are covered under by the principle of mutuality, as the contributors and the trust cannot be dissected as two separate persons.
- Investment Manager provides services of asset management to the contributors, and the trust is a 'pass through', wherein funds from the contributors are consolidated and managed.

Revenue's Contention

- The appeal is not maintainable as it involves the question of rate of duty/tax and, therefore the appeal shall lie to the Supreme Court.
- The trust is a separate legal entity, as it is registered under Venture Capital Fund Regulations issued under Securities and Exchange Board of India Act, 1992 ('SEBI'). Moreover, it has a PAN, operates a bank account, deducts tax at source (TDS), obtains variety of approvals etc. which are attributes of a 'person' and thus, the claim of the Appellant was improper.
- Definitions in the contribution agreements and other documents indicate a relationship between a buyer and a seller as the phrase used is 'purchase of units' and thus the doctrine of mutuality does not apply to the instant facts. Further, various articles of Indenture of Trust of the fund are contrary to the principle of mutuality.
- The trusts the fund accepts money from investors and makes profit by re-investing and distributes the profits to investors; and retains some portion of the same to its benefit.

Discussion and findings

- The instant appeal involves the question of levy of tax, and there is no dispute as to the rate of duty/tax, thus, the said appeal is maintainable before the High Court and does not lie to the Supreme Court. The Court relied on the decision in **Commissioner of Central Excise, Hyderabad v. M/s Shriram Refrigeration Industries²**.

- Though various statutes such as that of SEBI, GST, IBC etc. recognize 'trust' as a person however, the Finance Act, 1944 (that contains the law of Service Tax) does not regard a trust as a person. The question involved in the appeals are with regard to payment of Service Tax under the Finance Act, 1944 hence, the contention of the Revenue-Department that the trusts are a 'person' is not legally tenable. The Court held that trusts are not juridical person as per and for the purposes of the Finance Act, 1994.
- The trusts act as a pass through, wherein funds from contributors are consolidated and invested by the investment manager. It acts as a trustee holding the money belonging to contributors to be invested as per the advice of the Investment Manager. Trusts neither provide any services nor make any profit and so, with the result that no monies are left over with it after distribution to the contributors and payment of expenses. Hence, imposition of Service tax is not sustainable.
- Money is contributed by the institutional investors, (contributors) and held by the trust. Doctrine of mutuality applies when commonality is established and, in the instant case the Appellant acts as a trustee holding money belonging to the contributors, which is invested as per the advice of Investment Manager. Thus, these (contributors and respective trusts) cannot be dissected as two different entities. It was noted that there cannot be service to self, much less tax on it.

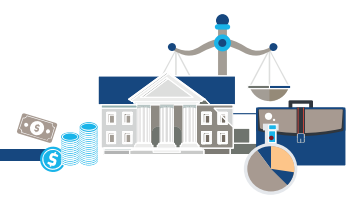
Judgement

- Based on the above findings, the High Court allowed the appeals, adjudging the matter in the favour of the Appellants.

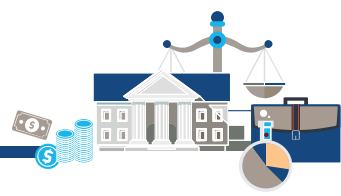
Dhruva Comments

This judgment reinforces the industry-wide position and practice. The Court considered the substance of the arrangement and transactions, rather than its form to render its ruling.

² 2022-VIL-76-SC-CE



The ratio of this judgement will be tested in the GST regime and beneficially deployed too. Even though definition of the term 'person' includes 'trust' and, the concept of mutuality is nearly neutralised by the Explanation to the term 'supply', which stipulates that *inter se* transactions between a person and its members are deemed to be liable, it can be inferred from the judgement that there is no service (supply) as also no consideration in the arrangement (between contributors and trusts), whereas, the trusts act as a pass through. This judgment should allay concerns of applicability of GST to the Venture Capital Funds / Alternate Investment Funds and the like.





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