Trusts Over Wills – Redefining Indian Succession Planning

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Succession planning is no longer a reactive exercise but a proactive necessity for business families, high-net-worth individuals (HNIs) and ultra-HNIs. As family assets become more diverse, family structures more complex and global, and regulations more complicated, there is a growing recognition that traditional tools like wills and nominations may fall short in ensuring smooth, tax-efficient, and dispute-free wealth transition.

Traditionally, the most common methods of succession in India include the following:

- Wills, which may be subject to legal challenges, and require probate in certain jurisdictions. Furthermore, wills may not be feasible where the personal laws (such as Sharia law) impose restrictions on succession of assets through will.
- Gifts during lifetime, which may result in loss of ownership and control over the assets during the lifetime itself.
- Joint ownership of assets, which may trigger ownership ambiguity and potential disputes in the family after lifetime of family patriarch.
- Nominations, which often lead to confusion between legal ownership and beneficial interest.
- Hindu Undivided Families, or family arrangements, which are increasingly proving to be rigid in the face of evolving family dynamics.

Private trust structures are emerging as a preferred mechanism for smooth, efficient, and dispute-free inter-generational wealth transfer, offering unique advantages over the conventional approaches referred above.

How is a Trust created

A Trust is a legal arrangement, whereby the owner of the assets (‘Settlor’) transfers / settles the assets in a Trust, and appoints a Trustee to manage the said assets, with a direction that the assets are to be applied for the benefit of the intended Beneficiaries. A Trust gets created on execution of a Trust Deed by the owner of the assets. Private trusts in India are governed primarily by the Indian Trusts Act, 1882. The Trust Deed governs the functioning of the Trust, including terms of management, distribution, and succession.

Parties to a Trust

- **Settlor (Author of the Trust)**: The person who creates the trust and transfers assets to it.
- **Trustee(s):** Individual(s) or corporate body holding legal title to trust assets for the benefit of the beneficiaries, and are responsible for administering the assets per the trust deed.
- **Beneficiary/Beneficiaries:** The person(s) entitled to enjoy the benefits of the trust property.
- **Protector (optional):** A supervisory role, often used in complex or offshore trust structures, to oversee trustee decisions

Types of Trusts

- **Determinate Trust** – In a Determinate Trust, the shares of beneficiaries in the assets of the

Trust, and their entitlements are clearly defined in the Trust Deed. Thus, the application or distribution of the assets by the Trustee has to be made in the proportions defined in the Trust Deed.
- **Discretionary Trust** – In a Discretionary Trust, the shares of the beneficiaries are not defined, and the application or distribution of assets from the Trust to the beneficiaries is at the discretion of the Trustee. Though the proportions of distribution are at the discretion of the Trustee, the beneficiaries to whom the distributions can be made are defined in the Trust Deed itself.
- **Revocable Trust** – A Revocable Trust is where the assets settled in the Trust can be revoked or taken back by the Settlor.
- **Irrevocable Trust** – An Irrevocable Trust is where the assets settled in the Trust cannot be revoked or taken back by the Settlor.

In the context of succession planning, the Irrevocable Discretionary Trust is often favoured for its ability to protect assets from external claims, maintain confidentiality, and allow conditional or staggered distributions over time.

Potential Advantages of a Trust Structure

A Trust Structure offers following significant advantages over traditional mechanisms of succession planning:

- **Smooth succession** – Trusts are operational during the lifetime of the Settlor and continue their existence after the demise of the Settlor. This ensures a seamless transition of control and ownership, without the delays associated with probate proceedings and related disputes.
- **Asset Protection and Ring-Fencing** – Where the Trust is discretionary in nature, the share of the beneficiaries is not defined. This ensures that the assets held in a trust are generally protected from claims by creditors on personal assets, matrimonial disputes, or business-related litigation (such as personal guarantees), freeze of assets in case of any criminal proceedings etc., depending on the applicable laws.
- **Protection from Estate Duty / Inheritance Tax** – While India does not currently impose estate tax, there is increasing discussion on its reintroduction. Multiple developed countries such as USA do impose the Estate Duty / Inheritance Tax on the succession of assets on death. The erstwhile Estate Duty laws in India (now abolished) levied estate duty as high as 85%. Assets in an irrevocable discretionary trust may be excluded from the personal estate of the settlor, thereby potentially offering estate duty protection.
- **Separation of Ownership and Control** – Legal ownership of the assets in the Trust assets lies with the Trustee, while the beneficiaries enjoy beneficial interest. This ensures that assets are not misused and are distributed in a controlled and phased manner. This may be especially useful in cases where a large family with multiple branches wants to segregate control for each segment of the business, while retaining common ownership of family as a whole over the business.
- **Confidentiality** - Unlike wills, which become public documents upon probate, Trust Deeds are private contracts and offer confidentiality in succession planning.
- **Flexibility and conditional succession** – Trust structures allow for conditional, staggered, or event-based distributions (e.g., upon attaining a certain age, educational milestone, or business involvement). Such flexibility may not be always available through a will.

The aforesaid benefits, especially the ring-fencing of assets and protection from estate duty, make Trust Structure an attractive alternative, especially for families with a complex family tree with multiple family members. Meticulous listing of assets, and laying down a clear plan for succession of assets becomes a key factor in ensuring seamless inter-generational transfer, minimizing disputes, and preserving family wealth in a structured manner.

Case Study – A Simple Family Business Succession Using a Private Trust

Background – Mrs. Raveena Mehra, aged 65, is the sole owner of ‘Mehra Textiles’, a successful mid-sized textile manufacturing business in Pune. Over four decades, she has also acquired:

- The factory premises (immovable property)
- A small commercial building generating rental income

- A diversified portfolio of shares and mutual funds

She has two children:

- **Rohit (40)** – Actively manages the textile business.
- **Riya (37)** – A schoolteacher, not involved in the business.

Succession Concerns:

1. Mrs. Mehra wants **Rohit** to manage and control the business after her lifetime, but also wants **Riya** to benefit financially from its success.

2. Mrs. Mehra wishes to avoid **probate delays** and any dispute between the siblings.

3. She is aware of the risk of **claims** against Rohit in his personal capacity

Solution:

Raveena sets up an Irrevocable Discretionary Trust under the Indian Trusts Act, 1882 during her lifetime.

- **Settlor:** Raveena transfers shares of her business entity, commercial property, and investment portfolio to the trust.
- **Trustee**: A trustee is appointed to ensure neutrality, along with Rohit as co-trustee for business-related decisions.
- **Beneficiaries**: Both Rohit and Riya are named beneficiaries.
- **Trust Deed Provisions**:

o The trustees will distribute business income (received as dividend from business entity) annually to both children, in proportions they decide, based on need and circumstances.

o Control over business management rests with Rohit, but the trust retains legal ownership of shares. Thus, the shares of business entity are protected from any claims made against Rohit in his personal capacity

o Riya receives fixed annual distributions from the rental income to ensure financial independence.

Outcome:

When Raveena passes away, the trust continues without probate proceedings.

- **Rohit** runs the business, without fear of asset fragmentation or legal disputes over ownership.
- **Riya** enjoys a secure income stream from the trust without being drawn into business operations
- The family avoids delays, legal costs, and the risk of forced asset sales, while maintaining confidentiality

<u>Key Tax Implications</u>

Transfer of assets by the Settlor to the Trust has been granted a specific exemption from levy of tax under section 56(2)(x) of the Income-tax Act, 1961, where the Trust has been formed for the benefit of the family members of the Settlor. However, in case the intended beneficiaries comprise of non-family members, potential tax implications may get attracted. Furthermore, there is no capital gains tax liability in hands of a settlor who is an individual, where the assets are settled in an irrevocable trust.

In case of an irrevocable discretionary trust, the income of the Trust is taxed at Maximum Marginal Rate ('MMR'). While this may be a downside, the HNIs / UHNIs may not be worse off due to the same, as the income would even otherwise be taxable at the highest slab rates.

<u>Key Considerations</u>

While the Trust Structure does offer significant benefits, various factors need to be duly considered while evaluating a Trust Structure for succession planning. Some of the key considerations have been enlisted below:

- Implications under the Foreign Exchange Management Act, 1999 ('FEMA') and any other regulations, especially where the family members comprise of non-residents, or the assets are a mix of Indian assets plus foreign assets;
- Potential tax and estate duty implications arising in other jurisdictions, where the family members comprise of residents / citizens of countries other than India. Setting up of Trust Structure in other jurisdictions, with or without a Trust Structure in India may have to be evaluated in such cases;
- Stamp duty on transfer of assets to a trust varies across states by asset type and classification under local stamp laws. While it results in an immediate cash outflow, it is usually not material in the overall context of long-term succession planning benefits
- Implications under the SEBI Regulations, where the assets comprise of shares of listed entities, especially when there is a control over listed entities or where the family members are promoters / directors;
- Trustee Selection and Trustee Succession - A critical component of trust governance is the choice of trustee. Trustee succession should also be planned proactively. The trust deed should include provisions for appointment, removal, and replacement of trustees, particularly in long-duration trusts where generational transitions are expected.

Conclusion:

The private trust offers a legally robust and operationally flexible framework for succession planning. By separating legal and beneficial ownership, providing asset protection, and allowing for tailored distribution mechanisms, it addresses the limitations inherent in traditional methods of succession.

However, as with any structuring exercise, the design of a trust must be tailored to the settlor's asset profile, family circumstances, and jurisdictional considerations. Understanding both the foundational legal principles and the nuanced practical implications is essential to crafting solutions that preserve wealth, minimise disputes, and ensure compliance across relevant legal and tax regimes.