

A. V. Reddy Trust

Vs

Commissioner of Wealth Tax

Civil Appeals Nos. 6077-80 of 1990

(D. P. Wadhwa, M. B. Shah JJ)

08.10.1999

JUDGMENT

SHAH J.-

These appeals are filed against the common judgment and order dated 8-12-1987 passed by the High Court of Andhra Pradesh in Referred Cases Nos. 37-40 of 1983 in reference made to the High Court under Section 27 of the Wealth Tax Act, 1957. The Income Tax Appellate Tribunal referred the following question for decision in all the four cases:

"Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that only the value of the interest of the beneficiary in the Trust could be included in the net wealth and not the value of the corpus of the Trust itself."

2. The facts in brief are that one Shri A.V. Reddy of Kadiam in East Godavari District created four Trusts for the benefit of his three grandchildren and daughter. One trust was created for the benefit of his grandson Dexter Anand Sear (eldest son of his daughter Margaret) and the relevant trust deed was executed on 14-3-1972. Another trust deed was created on 3-10-1970 for the benefit of the settler's grandson Harish Reddy. Third trust deed was created on 2-10-1970 for the benefit of the settler's grandson B.V. Satish Reddy and fourth trust deed was created on 6-7-1971 for the settler's second daughter Mrs. Lalitha Anderson. The trust deeds were similar; the author of the Trust constituted himself as the sole trustee; he had the discretion to apply whole or any portion of the income for the beneficiary and accumulate the residue by investing; the trust funds were to be transferred and made over to the beneficiary of the Trust after completion of the age of 45 years in the case of his daughters and 25 years in the case of his grandsons; if the object of the Trust could not be fulfilled the trust property was to be applied for the children of the beneficiary or other children. The Trusts created by the settler are on a uniform pattern, namely, at the time of settling the trust, a sum of Rs. 1116 was settled with the provision to augment the trust funds from time to time by further contributions. The settler appointed himself as the sole trustee during his lifetime. The trustee A.V. Reddy filed the wealth tax returns for the four Trusts showing the entire value of assets held by the Trust for the purpose of wealth tax assessment. On 27-3-1980, the Wealth Tax Officer made assessments under Section 16(3) of the Wealth Tax Act.

3. Against those orders, the assessee preferred the appeals before the Appellate Assistant Commissioner. In those appeals, the method of valuation of the wealth tax (sic net wealth) was disputed; additional ground was raised by contending that in view of section 21 which applied to all trusts only interest of the beneficiary should be assessed to wealth tax and not the entire corpus of the trust fund. By order dated 29-11-1980, the appeals were allowed. The appellate authorities

directed the Wealth Tax officer to assess the beneficial interest according to Section 21(1) or Section 21(2) of the Wealth Tax Act. Against that order, the Wealth Tax Officer preferred appeals before the Income Tax Appellate Tribunal, Hyderabad (hereinafter referred to as "the Tribunal"). The Tribunal arrived at the conclusion that the corpus of the Trust was to be transferred to the beneficiary on completing the beneficiary only on reaching the stipulated age. The Tribunal, therefore, held that there was only a contingent interest in the corpus of the Trust till the beneficiary attained the stipulated age and what could be included in the hands of the assessee would be the interest of beneficiaries in the terms of the trust and not the corpus of the trust fund itself. The appeals were, therefore, dismissed with clarification with which we are not concerned.

4. The High Court after considering the various contentions and the decision relied upon by the counsel for the parties and the terms of the trust deed arrived at the conclusion that the fund is held by the trustee on behalf of and for the benefit of the beneficiary or the beneficiaries whose interest may come to surface at a future date depending upon the happening of the events provided in the trust deed; on the valuation dates under consideration, it was not possible to say that the trustee held the fund of the Trust on behalf of or for the benefit of known beneficiaries and much less could it be said that the shares of the persons on whose behalf the trust fund is held were determinate and known. Hence, the wealth tax assessment is to be made under Section 21(4) of the Act; the trustee will have to be assessed on the entire value of the trust fund in the status of an individual. Thereafter, the Court upheld the assessment made by the Wealth Tax officer subject to nay relief in the quantum granted either by the Appellate Assistant Commissioner or by the Income Tax Appellate Tribunal. That finding of the High Court is challenged in these appeals by special leave.

5. The learned counsel for the appellants submitted that in these cases, wealth tax assessment is required to be made under Section 21(1) or Section arrived at the conclusion that assessment is to be made under Section 21(4) of the Act, yet it committed error in giving final direction contrary to the ratio laid down by this Court in the case of CWT v. Trustees of H.E.H. Nizam's Family Trust<sup>1</sup>. He submitted that once it is held that the Trust was valid, the wealth tax assessment is required to be made on the basic of the cocorpus of the trust fund but is to be made on the basis of the beneficiaries' interest as discussed by this Court in detail in Mizam's Family Trust case<sup>1</sup>. He submitted that once it is held that the Trust was valid, the wealth tax assessment is required to be made under the provisions of Section 21(1) or Section 21(4) of the Wealth Tax Act and, in such cases, the assessment is not to be made on the basis of the corpus of the trust fund but is to be made on the basic of the beneficiaries' interest as discussed by this Court in detail in Nizam's Family Trust case<sup>1</sup>.

6. In our view, there is much substance in the contention raised by the learned counsel for the appellant because after arriving at the conclusion to the effecting that wealth tax assessment is required to be made under Section 21(4) of the Wealth Tax Act, the Court erroneously held that it is to be assessed on the entire value of the trust fund in the status of an individual and the said directions are contrary to the ration laid down in Nizam's Family *Trust Case*<sup>1</sup>.

7. Regarding the contention of the learned counsel for the appellant that assessment is required to be made under Section 21(1) or Section 21(2), we would refer to the relevant terms of the trust deed on which the High Court has relied upon. They are as under:

"18. The trustee for the time being may at his discretion apply the whole or any portion of the income of the trust fund for the maintenance, education or advancement in life of the beneficiary and shall accumulate all the residue by

investing the same in the aforesaid manner.

20. On the beneficiary completing the age of 25 years the trustee shall transfer and make over to the beneficiary all the trust funds and on so transferring this trust deed shall stand cancelled and be of no effect.

21. If the object for which the Trust has been created fails and cannot be fulfilled, the trustee for the time being shall be at liberty to apply the trust property to the benefit of the other sons, daughters of my last daughter Mrs. Margaret Anne Reddy Sear in the Proportion of one share for a son and half-share for a daughter."

8. On the basic of the aforesaid terms and conditions, it is apparent that right of the beneficiaries to get the corpus of the trust fund come into existence at the future date when the condition regarding the survival is fulfilled. The High Court, therefore, rightly arrived at the conclusion that interest of beneficiary is indeterminate or unknown and is contingent and, therefore, held that Section 21(4) would be applicable. In this view of the matter, there is no substance in the contention of the learned counsel for the appellant that the Trust should be assessed under Section 21(1) of the Wealth Tax Act.

9. Once it is held that assessment is to be made under Section 21(4), there is no question of assessing the wealth tax on the entire value of the trust fund, In such a situation, in the case of Nizam's Family Trust case<sup>1</sup> this Court has laid down that two assessments are required to be made on the trustee; one in respect of actual valuation of the life interest of the beneficiary under sub-section (1) of Section 21 and the other in respect of actual valuation of the totality of the beneficial interest in remainder as if it belonged to one individual under sub-section (4) of Section 21, it is beneficial interests which are taxable in the hands of the trustee in a representative capacity and the liability of the trustee can not be greater than the aggregate liability of the beneficiaries and no part of the corpus of the trust property can be assessed in the hands of the trustees under Section 3.

10. This aspect is considered in detail in the aforesaid decision. The Court first reproduced the relevant part of Section 21, as it stood at that time, as under:

21. Assessment when assets are held by courts of wards, administrators general, etc.-  
(1) Subject to the provisions of sub-section (1-A), in the case of assets chargeable to tax under this Act, which are held by a court of wards or an administrator general or an official trustee or any receiver or manager or any other person, by whatever name called, appointed under any order of a court to manage property on behalf of another or any trustee appointed under a trust declared by a duly executed instrument in writing, whether testamentary or otherwise (including a trustee under a valid deed of wakf), the wealth tax shall be levied upon and recoverable from the court of wards, administrator general, official trustee, receiver, manager or trustee, as the case may be in the like manner and to the same extent as it would be leviable upon and recoverable from the person on whose behalf or for whose benefit the assets are held and the provisions of this Act shall apply accordingly.

(2) Nothing contained in sub-section (1) shall prevent either the direct assessment of the person on whose behalf or for whose benefit the assets above referred to are held, or the recovery from such person of the tax payable in respect such assets.

(3)

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(4) Notwithstanding anything contained in the foregoing provisions of this section, where the shares of the persons on whose behalf or for whose benefit any such assets are held are indeterminate or unknown, the wealth tax shall be levied upon and recoverable from an individual who is a citizen of India and resident of India for the purposes of this Act, and

- a. at the rates specified in Part I of Schedule (I); or
- b. at the rate of three per cent;

whichever course would be more beneficial to the Revenue."

(emphasis supplied)

11. After considering the various contentions raised by the parties and exhaustively dealing with the provisions of the Wealth Tax Act, the Court, *inter alia*, held thus:

- a. Charging Section 3 of the Wealth Tax Act is made expressly subject to Section 21 and it must yield to that section insofar as the latter makes a special provision for assessment of a trustee of a trust. Section 21 is mandatory in its terms.
- b. Once it is established that a trustee of a trust can be assessed only in accordance with the provisions of Section 21 and under these provisions, it is only the beneficial interests which are taxed in the hands of the trustee, it must follow as a necessary corollary that no part of the value of the corpus in excess of the aggregate value of the beneficial interest can be brought to tax in the assessment of the trustee.
- c. Under the scheme of Section 21, the Revenue has two modes of assessment available for assessing the interest of a beneficiary in the trust properties; it may either assess such interest in the hands of the trustee in a representative capacity under sub-section (1) or assess it directly in the hands of the beneficiary by including it in the net wealth of the beneficiary. What is important to note is that in either case what is taxed is the interest of the beneficiary in the trust properties and not the corpus of the trust properties. So also where beneficiaries are more than one, and their shares are indeterminate or unknown, the trustees would be assessable in respect of their total beneficial interest in the trust properties.
- d. Under sub-sections (1) and (4) of Section 21 it is the beneficial interests which are taxable in the hands of the trustee in a representative capacity and the liability of the trustee cannot be greater than the aggregate liability of the beneficiaries, no part of the corpus of the trust properties can be assessed in the hands of the trustee under Section 3 and any such assessment would be contrary to the plain mandatory provisions of Section 21.
- e. For making it clear as to how the wealth tax is to be computed, the Court gave an illustration for assessment under sub-sections (1) and (4) of Section 21. In a case where property is held on trust for giving income for life to A and on his death, to such of the children of A as the trustee might think fit. The court held that Section 21 sub-section (4), would be clearly attracted in such a case so far as the reversionary interest is concerned, because, on the relevant valuation date, the interest is concern, because, on the relevant valuation date, the remainder men and their shares would be

indeterminate and unknown. But here also two assessments would have to be made on the trustee – one in respect of the actuarial valuation of the life interest of A and the remainder man's interest would not be assessable in the hands of the trustee because, as pointed out above, the trustee can be taxed only in respect of the beneficial interests and there being no other beneficiary apart from A and such of the children of A as the trustee might think fit, the balance of the value of the corpus cannot be brought to tax in the hands of the trustee under sub-section (1) or (4) of Section 21.

- f. The correct interpretation of sub-section (4) of Section 21 must, therefore, be that even where the beneficiaries of the remainder are indeterminate or unknown, the trustee can be assessed to wealth tax in respect of the totality of the beneficial interest in the remainder, treating the beneficiaries fictionally as an individual.

12. In view of the aforesaid discussion, we agree with the findings given by the High Court that in the case of the appellant Trust beneficial interest is to be assessed to wealth tax in the hands of the trustee under Section 21(4) of the Act. However, the direction given by the High Court that "Trustee will have to be assessed on the entire value of the trust fund in the status of individual" is contrary to the direction given in *Nizam's case*<sup>1</sup>.

13. In the result, the question is answered party in favour of the assessee and against the Revenue. The appeal is allowed with costs.

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