



Bombay Chartered Accountants' Society

7, Jolly Bhavan 2, Ground Floor, New Marine Lines, Mumbai - 400 020

Tel. : + 91 22 6137 7600 Website : www.bcasonline.org

E-Journal : www.bcasonline.org E-mail : bca@bcasonline.org

www.elearning.bcasonline.org

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Sunil Gabhawalla

Vice President
Manish Sampat

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Mihir Sheth

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Date: 18th March, 2019

To,
Principal Chief General Manager,
Non-Resident Foreign Account Division (NRFAD) – Policy Division,
Foreign Exchange Department,
5th floor, Amar Building,
Reserve Bank of India, Mumbai - 400001



Dear Sir,

Sub: Private Trusts for Indian assets – Clarification required

We request for a clarification on Indian Trusts with non-resident beneficiaries in respect of Indian assets. Indian residents' wealth has grown. There is a demand for setting up of Trusts for smooth succession of assets to the next generation. Several people have already set up Trusts and are functioning. However FEMA is silent on this subject. As there is no clarity, people are not certain whether the trusts are all right. This matter has been discussed in our association and we were of the view that if RBI could issue a clarification, it will be beneficial to India. People would not mind to retaining the funds in India as per FEMA.

Further background is given below.

Trust can have a variety of situations. In this letter we have covered one kind of trusts.

1. Requirement of a Trust:

The subject of Private Trust is an old concept in the Indian law. The Indian Trust Act was enacted in 1882. For past few years wealth of Indian residents has grown. To avoid disputes on death of the person, Trust is one of the important instruments which can be useful.

In case of a Will, the assets are transferred after the death of the person. Some of the difficulties which can come up in case of a Will are:

- i) Some disgruntled persons can challenge the genuineness of the Will. The court case can take years to settle.
- ii) A Will requires a probate from the court in many situations. This is a time consuming and costly affair.
- iii) If the ownership of the shares of public limited company is in dispute, voting on those shares cannot be done. The rightful owner of shares can come into difficulties if he cannot vote.

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Therefore if the wealth is transferred to a Trust **during lifetime** of the owner of wealth, the chances of challenge are reduced considerably. Difficulties can be reduced considerably.

As long as all members are Indian residents, there is no difficulty under FEMA. However today, families have members who are residents and non-residents. In this situation, FEMA comes into picture.

It is not clear if a person can form a Trust in India with non-resident beneficiaries. **Legally when a settlor transfers his assets to a trust with non-resident beneficiaries, it is as good as a gift being made to non-resident beneficiaries.** The only restriction is that the beneficiary will be entitled to use the assets when the trustee distributes the same to the beneficiaries. A gift is permitted under FEMA only as specified in the regulations (e.g. under LRS).

Further a **Trust is not a person** under the Indian Trust Act. It is only a contract between the settlor and trustee. However for some situations under FEMA, a trust is considered as a person (e.g. mutual funds, Investment Vehicles). This creates avoidable confusion.

The trust has several permutations and combinations. It is almost impossible to consider all of them. In this representation, we are requesting for a clarification for a **Trust in India by an Indian resident for his Indian assets where beneficiaries are non-residents.** More details are given below. If the clarification could be issued, it will be really helpful.

2. Mechanism of a Trust:

A **settlor** (usually the family head) transfers his property in a Trust. Property may be cash, securities, real estate etc. Property can be transferred to the Trust later also. Other family members also can transfer the property to the Trust. These are considered as **donors**. For example, father can make the Trust. He will be the settlor. Mother can transfer the property. In a joint family, other relatives can also transfer the property. They will be donors. The settlor and relatives can be an Indian resident or a non-resident. However in this note, we are restricting it to Indian residents.

The **beneficiaries** are stated in the Trust deed. The beneficiaries can be existing family members and even those yet to be born. They can be charitable organisations also. Some families also keep their old employees as beneficiaries – such as governesses, teachers, etc. Settlor/donor can also be the beneficiaries. Beneficiaries can be residents and non-residents.

A **Trustee** is appointed to manage the assets. He will manage the property and use the property for the benefit of the beneficiaries. He may use the assets for expenses of beneficiaries like education, or just distribute the funds to the beneficiaries. There can be one trustee or more than one trustee. The settlor / donor also can be the trustee. Trustees can be residents and non-residents.

The trust can come to an end on happening of events as stated in the trust deed. Some of the events could be:

- i) Period of trust has expired.
- ii) Beneficiaries have reached a certain age.
- iii) Death of settlor / donor.
- iv) If the trustees pass a resolution to end the trust.

This is the simple explanation of a simple trust. There can be different structures for other bonafide purposes.

3. Usual FEMA restrictions:

Normally following FEMA restrictions apply.

3.1 An Indian resident cannot create any interest in an Indian asset in favour of a non-resident. He cannot give any amount or assets to a non-resident. The only exceptions are:

He can transfer funds (currently up to US\$ 2, 50,000) under LRS to a non-resident – i.e. he can remit funds abroad or transfer funds to NRO account in rupees.

He can give a gift of immovable property to an NRI / OCI relative.

He can gift shares of an Indian company by taking RBI approval for an amount of up to US\$ 50,000.

Wealthy Families cannot transfer the assets with assets exceeding the above amounts to non-residents.

3.2 An NRI cannot transfer Indian funds (non-repatriable funds / assets) abroad beyond US\$ 1 mn. per year.

4. RBI can issue clarifications so that trusts can be settled while complying with existing restrictions. As this is a complex matter, a detailed clarification will be better.

We understand that any law is susceptible to misuse. Therefore we may emphasise that one should not be able to use a Trust to transfer funds outside India more than what is normally permissible under FEMA regulations for residents or non-residents.

Considering this, if a clarification is issued on the following lines, it will be helpful.

4.1 An Indian resident (settlor or donor) can transfer his assets in India to a Trust in India without limit.

4.2 The trustee can be a resident or a non-resident. A trustee is akin to a custodian and he acts in a fiduciary capacity. Hence his being a legal owner should not make any difference. He does not get any rights in trust property unless he is also a beneficiary.

However Trustee can charge fees to manage the trust. If a trustee is a non-resident, his fee will be revenue expenditure comparable to fees payable to non-resident directors of Indian companies.

4.3 The beneficiaries can be any resident or a non-resident. (This is in line with what a person can do in his Will. The settlor can bequeath his wealth to any person. Whether the person who inherits the property requires an approval from RBI to hold it, will depend on the kind of property. For Trust also it can be provided that if a non-resident receives property from a trust on distribution, he may be required to take an approval if he would need an approval as in the case of a direct transfer.)

4.4 The amount which can be spent out of the trust for the benefit of the beneficiary, or the amount which can be distributed to the beneficiaries will not exceed the amounts which could have been spent or distributed if the beneficiary were to receive the same directly from the settlor / donor.

In other words, if the beneficiary is an Indian resident, there will be no limit. If the beneficiary is a non-resident, the amount cannot exceed US\$ 2, 50,000 per year (or as may be permitted under LRS from time to time) for each settlor / donor. However if the funds are to be used for education and medical expenses, the amount can be more than the LRS limit. Thus it will be in line with the LRS limits. Funds can be deposited in the NRO account or can be remitted abroad.

4.5 On death of the settlor / donor the distribution can be up to the same limit which NRI could have remitted if he had inherited the assets from the settlor / donor (currently the limit is US\$ 1 mn.). If more than US\$ 1 mn. is to be remitted, an application can be made to RBI. This is similar to the position in case of a Will, where if the heir wants to remit more than US\$ 1 mn, he can approach RBI with an application.

The whole objective is that what a person can do directly, he can do through a trust. What he cannot do directly, he cannot do indirectly through a trust.

4.6 Depending on the trust deed and the laws of foreign country and India, either the beneficiary or the trustee could be liable to income-tax on income earned by the trust. If any tax is payable by the beneficiary or the trustee, the same can be paid out of trust funds. Either the tax can be paid by the trust directly, or the tax amount can be transferred to the trustee or the beneficiary as necessary.

4.7 The trust can hold / invest only those assets which a beneficiary can hold / own. Thus if all beneficiaries are NRIs, the trustee can invest in immovable properties just as an NRI can do. If any beneficiary is not an NRI, no investment can be made in immovable property.

4.8 If the trust does not fulfil any of the criteria stated above, he can approach RBI for a specific approval to settle a trust.

4.9 Example:

The above principles are explained by way of an illustration:

Indian residents Mr. IR and Mrs. IR have property in India worth Rs. 100 cr. They would like to settle Rs. 75 cr. in an Indian Trust and keep Rs. 25 cr. for their personal use.

Their one son is in India and another son is in UK (NRI). They would like to make their sons (and their families) equal beneficiaries in the Trust. This would mean they are transferring Rs. 37.5 cr. of assets in India to each of their sons – except that the sons will be able to fully enjoy the assets as per the Trust deed (see para 2 above). Under the income-tax law also, the income would be taxable as if the sons had earned the income. Mr. and Mrs. IR would not be liable to tax.

Normally Mr. and Mrs. IR will not be able to give a gift of Rs. 37.5 cr. to the NRI son. In this representation we are requesting that a clarification may be issued that such a transfer to an Indian trust where NRI is the beneficiary, should be permitted.

This will be subject to the following conditions:

If the funds from the trust are distributed, the NRI son will be able to receive only an amount of up to US\$ 5,00,000 (US\$ 2,50,000 per donor): However if amount is to be distributed for education and medical expenses, it should be permitted beyond the LRS limit.

On death of the settlor, the NRI beneficiary can transfer assets out of India up to US\$ 1 mn. If there are more than one beneficiaries, each of them can transfer up to US\$ 1 mn. per year.

If more funds are required to be distributed for any reason, then an application can be made to RBI.

If income-tax is payable by the NRI in India or abroad, funds for the same can be distributed to the NRI, or the Trust can pay such tax directly.

5. Thus in essence, the proposal is that:

Through a trust only that much can be done which could be done through a Will – except that the beneficial interest in the assets is made in favour of non-resident before the death of the settlor / donor.

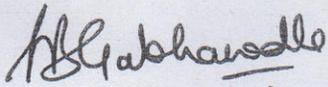
Non-resident beneficiaries cannot receive funds from the trust more than the LRS limit / US\$ 1 mn as the case may be. The exception will be education and medical expenses for which funds exceeding the LRS can be made.

6. **Our request** – RBI may issue clarification on settlement of Trust by Indian residents with non-residents as beneficiaries. If this request is accepted in principle, our society will be glad to assist in drafting circulars so that FEMA cannot be circumvented through trust.

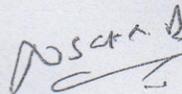
We understand that it may take some time for this matter. In the meantime if any interim circular can be issue on what should be done for the Trust, it will be most welcome.

We will be glad to explain the matter personally.

Thanking you,



CA Sunil Gabhawalla
President,
Bombay Chartered Accountants' Society



CA Mayur Nayak
Chairman,
International Taxation Committee