CHAPTER

2 Private Trusts Drafting and Case Studies

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Learning Objectives
• Introduction
• Private Trust: Meaning and Basic understanding
• Distinction of Private Trusts and Public Trusts
• Classification of Private Trusts
• Registration of Private Trusts under the Indian Trusts Act, 1882
• Trust Deed and Drafting
• Case Studies

2.1 Introduction

'Trust', in simple words, refers to transfer of property by one person to another who manages that property for the benefit of someone else. This basic understanding is embodied in Section 3 of the Indian Trusts Act, 1882, wherein the term "trust" has been defined by the lawmakers as "an obligation annexed to the possession of the property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the advantage of another or of another and also the owner". Trusts provide legal protection to properties of settlor of the trust, and ensure that the assets are distributed to the beneficiaries according to the wishes of the settlor.

The rationale and need for establishing a trust in India and the type of property settled in a trust have undergone a massive change over the years. This change can be predominantly attributed to the need of estate planning and tax optimisation by wealthy individuals.

Currently, types of trusts governed by the Indian Trusts Act, 1882 include private trusts and public trusts. This chapter provides a detailed insight into the manifold nuances relating to formation, registration, classification, uses, and other practical aspects surrounding private trusts in India. This chapter also touches upon drafting considerations for private trust deeds, and roles & responsibilities of trustees of a private trust.

2.2 Private Trust: Meaning and Basic Understanding

A private trust is a legal arrangement where one party known as the trustor settlor, transfers property to another party, the trustee, to be held and managed for the benefit of specific individuals or entities, known as beneficiaries. The formation of private trust gives this transaction a legal form and guarantees that property is used only for the benefit of his/her family and in a way the settlor wishes it to be handled.

Private trusts are incredible and convenient. Prime benefit of setting up a private trust and family trust is wealth protection, ring-fencing of control over assets, family succession planning and asset transfer for the benefit of family members both during and after the settlor's lifetime. The formation of private trust gives a guarantee to the settlor that money is used only for the benefit of his/her family members. The non-existence of mandatory probate requirements adds to the confidentiality trait of private trusts. The property of the private trust is managed as per the trust deed even after the settlor becomes incapacitated. The settlor can specifically mention objectives of the trust, name of beneficiaries, name of assets and manner of distribution of assets to beneficiaries which shall ensure seamless management of assets.

In light of the above understanding, the basic components of a typical private trust structure can be enlisted in brief as under:

- **Settlor/Contributor/Author:** Settlor vests the property in the trust and conveys legal title to the trustees. The settlor must clearly express an intention to create a trust by setting aside specific property for the benefit of the beneficiaries. This intention must be explicitly manifested through written or spoken words or conduct and cannot remain undisclosed.
- **Trustees:** Trustees hold legal title to the trust assets and manage the property. In other words, a trustee is responsible for supervision of the assets settled in the private trust. Since the trustee, who may or may not be the settlor, is responsible for executing the trust's purpose, the objects must be clearly articulated to ensure proper administration.
- **Beneficiaries:** Persons for whose benefit the trust is created. In modern commercial transactions and in view of the estate planning considerations, people often make companies/

firms/sub-trusts as beneficiaries, rather than individuals directly.

- **Trust Property (Assets):** Any movable or immovable properties including cash, gold, securities, house, land, etc. which is owned by the settlor. The trust must have a clearly defined and identifiable subject matter.
- **Instrument of Trust (Trust Deed):** The trust must be evidenced by a trust deed, indenture of trust, or any other formal instrument, which must expressly set out the objectives and terms governing the trust. A trust deed is a legal document that outlines the terms and conditions under which the trust will operate.
- **Protector:** Though not mandatory to appoint, appointing one is advisable in case trustees are not members of the family. Protector watches over the trustees and may terminate the trustee for any misconduct.

2.3 Distinction of Private Trusts and Public Trusts

A trust constituted wholly or mainly for the benefit of public at large is called a public trust. The purpose of a public trust is to benefit general public and not any private individuals or associations personally. It should ideally cater to all public without any discrimination and differentiation.

The main distinction between private trusts and public trusts are the beneficiaries. In a private trust, beneficiaries are closely knitted group of persons; and most importantly, are certain. This is not the case with public trusts, wherein the beneficiaries are not certainly determinable.

Other distinctions between public trusts and private trusts are as under :

- **Degree of Permanence:** Public Trust is more permanent than a private trust and cannot be dissolved, whereas generally private trusts are not permanent trusts. They can be dissolved in specific circumstances. If the private trust is created by execution of trust deed, it can be dissolved in the manner specified in the trust deed. If the trust is created through will, it can be revoked at any time during the lifetime of settlor of the trust.

- **Objects:** Private trusts cannot be charitable in nature, whereas such is not the case with public trusts, which can be both religious and charitable.
- **Option to Amalgamate:** Public charitable trusts have an option to merge with other public charitable trusts having similar objects; such option is not available in the case of private trusts.
- **Governing Statute:** Generally public trusts are governed by the Acts passed by the State Governments, whereas private trusts are governed by the Indian Trust Act, 1882.

2.4 Classification of Private Trusts

Post outlining the distinction between public and private trusts, it is important to delve into the intricacies of various types of private trusts. Mainly, private trusts are discretionary/specific trusts and non-discretionary trusts. These have been discussed in detail below:

- **Non-Discretionary/Specific Trusts:** In this type of trust, the settlor has full control over the decision as to which beneficiary shall receive which assets and how much. The trustee does not have the authority over distributing or paying out the trust assets. For example, the settlor may decide proportion of benefit to be received by his children.
- **Discretionary Trust:** In this type of trust, the settlor decides the list of beneficiaries alone. However, the settlor shall not be in a position to determine the proportion of assets to be transferred to beneficiaries. The proportion of assets to be given to each beneficiary will be decided by the trustee. According to *Mozley & Whiteley's Law Dictionary*, such trusts grant the trustees absolute discretion over the application of trust assets. Further, a well-drafted discretionary trust allows the trustee to include or exclude beneficiaries, thereby allowing the trustee greater flexibility to take decisions according to the circumstances. This type of trust is more suitable in cases where beneficiaries are minor.

- **Revocable/Irrevocable Trusts:** This distinction is primarily relevant for taxability of transfers to and from the private trust in accordance with the Income-tax Act, 1961. A revocable trust is a trust that allows the transferor to reclaim the assets or income transferred to the trust under certain conditions. In accordance with Section 61 of the Income-tax Act, 1961, any income generated from a revocable transfer of assets is considered taxable as the income of the transferor. This income must be included in the transferor's total income for tax purposes, ensuring that the transferor remains liable for taxation on the income derived from assets over which they maintain certain rights or control. Whilst revocable trusts do not provide tax benefits or creditor protection to the settlor, it does provide added flexibility and control over the assets.

  On the other hand, an irrevocable trust cannot be modified or altered by the settlor once it is established. The income generated from irrevocable transfers, including irrevocable transfer to trusts does not get clubbed in the hands of the transferor/settlor. Forming such trusts help achieving permanent asset protection and tax benefits including estate taxes (*if any*).

- **Testamentary Trusts/Will Trusts:** A trust can be created through a will, allowing the testator (*the person making the will*) to ensure that their assets are managed and distributed according to their wishes after their demise. Such trusts are called testamentary trusts. As per the Indian Succession Act, 1925, a person of sound mind, who has attained the age of majority, may make a valid will in writing and in the presence of two attesting witnesses.

  A testamentary trust comes into effect only upon the death of the testator and does not require separate registration during their lifetime. Since it does not take effect during the settlor's lifetime, he or she is free to make changes any time to the trust until death. The changes in the will can be made through a document known as "codicil" or by executing a new will. However, no changes can be made after the demise of the testator and the trust becomes irrevocable basis the last will of the testator.

  These trusts have gained international recognition as preferred vehicles for estate and succession planning. Generally, testamentary trusts are created for young children, relatives with disabilities or others who may inherit a large sum of money that enters the estate upon the death of the testator. Such a trust structure allows the settlor/testator to name a trusted guardian (*for minor beneficiaries*) as the trustee for managing the trust until the minor becomes old enough to manage the trust on his own. The primary downside of a testamentary trust is that it fails to provide immediate asset protection (*which a living trust is able to provide*).

- **Living Trusts:** A living trust, also called an *inter vivos* trust (*Latin for "between the living"*) is a legal arrangement created during a person's lifetime to hold and manage assets. Unlike a testamentary trust, a living trust operates while the settlor is alive and can be modified or revoked. Such trust takes effect immediately, as is also understood by the name.

It is important to note that irrespective of the type of private trust, beneficiaries should be determinate and known. It is well established principle that a private trust created for unknown beneficiaries is *void ab initio* and the property in the assets falls back to the settlor. The Supreme Court in *Deoki Nandan v. Murlidhar AIR 1957 SC 133* laid down the aforesaid principle to finality when it observed that "*In private trusts, the beneficial interest is vested absolutely in one or more individuals who are, or within certain time, may be definitely ascertained.* "

2.5 Registration of Private Trusts under the Indian Trusts Act, 1882

In India, any instrument that creates or transfers an interest in immovable property is generally required to be registered. A private trust deed transferring an immovable asset (e.g. land, building) from the settlor to the trustees qualifies as such an instrument. In particular, Section 17(1)(*b*) of the Registration Act mandates registration of "*non-testamentary instruments which purport or operate to create, declare, assign, limit or extinguish any right, title or interest*" in immovable property. Thus, to be legally effective and enforceable, a trust deed involving immovable property (above ₹ 100 value) must be executed on non-judicial stamp paper and registered in the Sub-Registrar's office where the property lies. Failure to register renders the deed void against third parties, and voidable against parties. Movable assets in the trust corpus do not require registration, though in practice all trust deeds are registered by convention. The deed must bear the requisite stamp duty, which is prescribed by each State's Stamp Act. Upon registration, the Sub-Registrar certifies the instrument, providing legal evidence of the trust's creation.

2.6 Trust Deed and Drafting

A trust deed serves as the cornerstone document through which a settlor formally creates a private trust. Far from simply recording the settlor's wishes, the trust deed fulfils a range of essential roles, including but not limited to the following:

- **Specification of Trust Objects:** A fundamental function of the trust deed is to clearly articulate the objects, or purposes, for which the trust is established. This specification is crucial for ensuring that the trust operates within the bounds of the law and fulfils its intended social, familial, or charitable objectives.
- **Trustee Appointment and Authority**: The deed sets out the protocols for how Trustees are to be chosen, removed, or replaced, the extent of their powers and discretions, and the scope of their rights and obligations. It also codifies the fiduciary duties owed by trustees to the beneficiaries.
- **Governance Framework:** The trust deed lays down the rules and procedures governing the administration of the trust. By establishing a clear governance framework, the deed safeguards the faithful execution of the trust's aims and helps prevent mismanagement or abuse of Trustee powers.
- ***Prima Facie* Evidence of the Trust:** By committing the trust arrangement to writing, the trust deed stands as the primary and most reliable evidence of the existence of the trust. In legal proceedings or disputes, the deed is typically accepted as conclusive proof - unless compelling contrary evidence is presented - that the settlor intended to create a trust and that such a trust was, in fact, established. Based on this Trust Deed, the trust is created and can even apply for PAN and open bank account in the name of the Trust.

- **Conveyance of Trust Property:** Through its terms, the deed identifies the specific property or assets that are to form the trust's corpus (the trust fund). It ensures that both legal title and beneficial interest in these assets are vested in the Trustees, who then hold and manage them for the benefit of the beneficiaries.

- **Contingency Planning and Dissolution:** Finally, the trust deed anticipates various contingencies that may arise during the trust's existence, such as the incapacity, resignation, or death of a Trustee. Additionally, the deed outlines the process for the eventual winding up or dissolution of the trust, specifying how remaining assets are to be distributed and how final accounts are to be settled.

2.6-1 *Key Components of Trust Deed*

Drafting a well-organized trust deed is essential not only to ensure smooth operation of the trust but also to secure its validity and enforceability under law. A clear, comprehensive deed lays the groundwork for transparent governance, delineates each party's rights and obligations, and provides the legal certainty necessary to protect both the trustees and the beneficiaries.

There is no specific prescribed format which is to be used for drafting a trust deed. A trust may be created by any language sufficient to show the intention and no technical words are necessary in the deed. A well-structured deed generally comprises the following provisions:

- Statement of trust and objects
- Name of the beneficiaries of the trust
- List of the properties settled and the method of settling the property to the trust
- Mechanism of distribution of trust property to the beneficiaries
- Type of the trust – Discretionary, Specific, Testamentary, etc.
- The manner of dissolution of the trust