



Tax alert: Surcharge of respective slab applicable in case of MMR

16 June 2025

The Special Bench of the Income-tax Appellate Tribunal (ITAT) has held that private discretionary trusts whose income is chargeable to tax at maximum marginal rate (MMR), surcharge has to be computed on the income-tax having reference to the respective slab rates prescribed in the Finance Act.

In a nutshell



- As per section 2(29C) of the ITA, the tax on the total income of the discretionary trust has to be determined by applying the MMR, as applicable to the highest slab of income relating to an individual, AOP or BOI specified in the Finance Act of the relevant year. Thereafter, the surcharge, if any, has to be computed on such income-tax.
- What should be the MMR of income-tax is to be determined based on the rate of income-tax provided in Finance Act of the relevant year.



- Under sections 164/167B r.w.s. 2(29C) of the ITA, tax as per MMR would mean 'the rate of tax applicable to the highest slab of income' under Item (1) of Paragraph A, Part (I) of First Schedule to the Finance Act 2023.
- The expression '*including Surcharge on income-tax, if any*', within the bracketed portion of section 2(29C) of the ITA, would mean the surcharge as provided in the computation mechanism under the heading 'surcharge on income tax' in Paragraph A, Part (I) of First Schedule to the Finance Act 2023.



- There is no conflict between provisions contained under section 164/167B, 2(29C) of the ITA and section 2 of the Finance Act. However, even assuming that there are some conflicts, a harmonious construction has to be made to avoid absurdity and make the provisions workable.



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Background:

- The taxpayer¹ is a private discretionary trust and had filed its return of income for the Financial Year (FY) 2022-23, corresponding to Assessment Year (AY) 2023-24, having income below INR 500,000. As per section 164 read with section 2(29C) of the Income-tax Act, 1961 (ITA) [related to taxation of discretionary trust] the taxpayer paid tax at the 'maximum marginal rate' (MMR).
- The Centralized Processing Centre, Bangalore (CPC) processed the return of income filed and levied highest rate of surcharge on the MMR at which the tax was computed.
- Being aggrieved, the taxpayer filed an appeal and in the course of appeals the matter reached before the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT). The ITAT in taxpayer's appeal for earlier year involving identical issue² held that in case of a private discretionary trust, where provisions of sections 164 and 167B [related to charge of tax in case of certain trusts] are applicable, the rate of surcharge would be the highest rate of surcharge provided under the Finance Act, irrespective of the quantum of income.

Upon finding that there are decisions of the ITAT holding contrary view, the taxpayer furnished an application before the President of the ITAT requesting to constitute a Special Bench (SB) for deciding the issue under consideration. Hence, an order constituting SB to decide the issue under consideration was formed, wherein other application from other taxpayers were also filed to join as interveners. Consequently, the issue in the case under consideration came.

Relevant provisions in brief:

- **Relevant extract of section 164 of the ITA:**

"164. (1) Subject to the provisions of sub-sections (2) and (3), where any income in respect of which the persons mentioned in clauses (iii) and (iv) of sub-section (1) of section 160 are liable as representative assessee or any part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown (such income, such part of the income and such persons being hereafter in this section referred to as "relevant income", "part of relevant income" and "beneficiaries", respectively), tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate" emphasis supplied.

- **Relevant extract of section 2(29C) of the ITA:**

"maximum marginal rate" means the rate of income tax (including surcharge on income tax, if any) applicable in relation to the highest slab of income in the case of an individual, association of persons or, as the case may be, body of individuals as specified in the Finance Act of the relevant year;

- Article 271 of the Constitution of India empowers the Union to impose surcharge for the purposes of Union. Whereas Article 265 of the Constitution mandates that no tax can be collected without authority of law; levy of surcharge has to be preceded by a law enacted by the Parliament authorizing such levy. Thus, in absence of any law authorizing levy of surcharge, it cannot be collected. Surcharge is recognized as a separate category and its collection is treated differently than the income tax levied at the specified rates.

Decision of the SB of the ITAT:

The SB of the ITAT acknowledged that the issue for consideration was whether the definition of MMR under section 2(29C) of the ITA could be interpreted in a manner to suggest that not only the rate of tax on the total

¹ Araadhya Jain Trust vs ITO (22)(1)(6) [2025] ITA No. 4272/Mum/2024 (Mum-Trib.)

² ITA No. 2197/Mum/2024 dated 7 October 2024

income of taxpayer would be at the highest rate, but even the surcharge to be computed on such tax would be at the highest rate.

The ITAT noted as below:

- As per section 2(29C) of the ITA, the tax on the total income of the discretionary trust has to be determined by applying the MMR, as applicable to the highest slab of income relating to an individual, AOP or BOI specified in the Finance Act of the relevant year. Thereafter, the surcharge, if any, has to be computed on such income-tax.
- Cojoint reading of sections 164/167B of the ITA provide for computation of income-tax at the MMR. However, there is no reference to levy of surcharge. Section 2(29C) of the ITA refers to surcharge. But this definition clause by itself does not fix the rate of tax, instead, it refers to the rate prescribed under the Finance Act of the relevant year.

Thus, what should be the MMR of income-tax is to be determined based on the rate of income-tax provided in Finance Act of the relevant year.

- As per section 2(1) of Finance Act, for the AY 2023-24, income-tax shall be charged at the rate specified in Paragraph A, Part (I) of First Schedule to the Finance Act 2023 and such tax shall be increased by a surcharge, collected for the purposes of the Union, calculated in each case in the manner provided therein.

As per the rates of income tax prescribed under Paragraph A, Part (I) of First Schedule to the Finance Act-2023, the highest slab of income is INR 1 million and above and the applicable rate of income tax is 30%. Thus, under section 2(29C) of the ITA, the MMR of tax will be 30% as applicable to the highest slab of income.

Under sections 164/167B r.w.s. 2(29C) of the ITA, tax as per MMR would mean 'the rate of tax applicable to the highest slab of income' under Item (1) of Paragraph A, Part (I) of First Schedule to the Finance Act 2023.

- Under the head 'Surcharge on income-tax' appearing in Paragraph A, Part (1), First Schedule it has been provided that the amount of income-tax computed as per the rate of income-tax under Item (1), (2) and (3) or under the provisions of section 111A or section 112 or section 112A or the provision of section 115BAC of the ITA, shall be increased by a surcharge, for the purposes of the Union, calculated in the case of particular class of taxpayer in the manner provided therein. There are different rates of surcharge on income tax, depending upon the categories of income.

The minimum rate of surcharge @ 10% on the income-tax is applicable only when the income of the taxpayer is above INR 5 million, but less than INR 10 million. Hence, if the total income is below the threshold limit of INR 5 million, there would be no surcharge.

- The first proviso under the heading 'Surcharge on income tax' carves out an exception regarding the rate of surcharge by stating that in case where taxpayer's total income includes dividend income or income under the provisions of section 111A, 112 and section 112A of the ITA [relating to capital gains on sale of shares], the rate of surcharge on the amount of income tax computed on that part of income shall not exceed 15%.

Hence, if the total income of taxpayer includes any income by way of dividend or income under certain provisions of the ITA, the rate of surcharge on tax computed on such part of income under no circumstances would exceed 15%.

- The expression '*including Surcharge on income-tax, if any*', within the bracketed portion of section 2(29C) of the ITA, would mean the surcharge as provided in the computation mechanism under the heading 'surcharge on income tax' in Paragraph A, Part (I) of First Schedule to the Finance Act 2023.

The expression 'if any', within the bracketed portion of section 2(29C) has to be read, not, *de hors* but in conjunction with computation mechanism provided under the heading 'surcharge on income tax' provided in section 2 of Finance Act. This view is further fortified by the object for which levy of surcharge was

introduced to the Finance Act – to augment the Revenue of the Union for developmental work by asking persons in the highest income bracket to contribute little more than the other citizens, for nation building.

- In the decision rendered in taxpayer's own case³ for earlier AYs, the ITAT while deciding the issue had placed reliance on earlier rulings⁴. These rulings did not touch upon the issue of levy of surcharge at the MMR and was not in dispute before the Courts. Thus, these rulings could not be considered to be laying down the proposition that as per the definition of 'MMR' under section 2(29C) of the ITA, levy of surcharge would also be at the MMR.

In view of the above, the ITAT held that in case of private discretionary trusts, whose income is chargeable to tax at MMR, the surcharge has to be computed on the income-tax having reference to the slab rates prescribed in the Finance Act under the heading 'surcharge on income tax' appearing in Paragraph A, Part 1, First Schedule, applicable to the relevant AY.

Comments:

Applicability of surcharge in case of trusts, i.e. whether the MMR would include only the tax rate to be at the highest rate or even includes surcharge to be applied at highest rate, irrespective of the quantum of income, is a matter under litigation for quite some time due to divergent rulings pronounced by the ITAT.

The SB of the ITAT in the current case, has upheld that surcharge would be based on the slab rates provided in the Finance Act and has held the following:

- As per section 2(29C) of the ITA, the tax on the total income of the discretionary trust has to be determined by applying the MMR, as applicable to the highest slab of income relating to an individual, AOP or BOI specified in the Finance Act of the relevant year. Thereafter, the surcharge, if any, has to be computed on such income-tax.
- What should be the MMR of income-tax is to be determined based on the rate of income-tax provided in Finance Act of the relevant year.
- Under sections 164/167B r.w.s. 2(29C) of the ITA, tax as per MMR would mean 'the rate of tax applicable to the highest slab of income' under Item (1) of Paragraph A, Part (I) of First Schedule to the Finance Act 2023.
- The expression '*including Surcharge on income-tax, if any*', within the bracketed portion of section 2(29C) of the ITA, would mean the surcharge as provided in the computation mechanism under the heading 'surcharge on income tax' in Paragraph A, Part (I) of First Schedule to the Finance Act 2023.
- There is no conflict between provisions contained under section 164/167B, 2(29C) of the ITA and section 2 of the Finance Act, however, even assuming that there are some conflicts, a harmonious construction has to be made to avoid absurdity and make the provisions workable.

There have been contradicting decisions of the ITAT on the applicable surcharge based on the income slab where the income is to be offered to tax at MMR. The decision of the SB will be useful for taxpayers in such cases. One will also need to examine if the income-tax return utility supports offering of applicable surcharge based on the slab rate. Taxpayers with similar facts may evaluate the impact of this ruling to the specific facts of their cases.

³ ITA No. 2197/Mum/2024 vide order dated 07.10.2024

⁴ CIT v/s C V Diwakaran Family Trust, Gosar Family Trust v/s CIT, CIT v/s J.K. Holdings



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