



Tax alert: Property received from settlor by trust set up for sole benefit of relatives, not taxable as IFOS

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The Chennai Bench of the Income-tax Appellate Tribunal (ITAT) has, based on facts of the case, held that the taxpayer trust was created only for the exclusive benefit of the relatives, including the settlor¹ himself and hence, the property (shares) received from a settlor (individual) was not taxable under section 56(2)(x) of the Income-tax Act 1961 (ITA).

In a nutshell



If the 'person' giving the property is an 'individual' and the Trust is created or established solely for the benefit of the 'relatives' of such 'individual', then such receipt of property by the Trust will not be taxable under section 56(2)(x) of the ITA.



The beneficiaries in the Trust deed comprised solely of the relatives of the settlor. There was no provision in the relevant clause or in any of the other terms of the Trust deed, by virtue of which any minority benefits could possibly accrue to any non-relatives of the settlor.

¹ the word "settlor" may also be read as "settlor" or vice versa

Background:

- The taxpayer² is a private trust settled by an individual ‘settler’ for the benefit of his family members.
- During the Financial Year (FY) 2021-22, corresponding to Assessment Year (AY) 2022-23. The taxpayer received shares by way of contribution from the settler. The taxpayer treated this receipt of assets not to be taxable under the exception set out in section 56(2)(x) of the Income Tax Act 1961 (ITA) [relating to taxability of property received without or inadequate consideration].
- During the audit proceedings, the Assessing Officer (AO) noted that though the beneficiaries of the trust comprised of the relatives of the settler, Clause 5.2 of the trust deed also permitted (a) the settler himself to be a beneficiary and (b) empowered the trust to add any entity as a beneficiary which is majority owned or controlled, directly or indirectly, either individually or collectively, by the relatives of the settler.

Therefore, it would mean that a minority benefit could possibly accrue to any person who is not a relative of the settler.

- Hence, the AO held that the taxpayer was not entitled to the exception laid down in clause (X) of proviso to section 56(2)(x) of the ITA and therefore added the aggregate value of shares as income of taxpayer under the head ‘other sources’.
- Aggrieved, the taxpayer filed an appeal and in the course of appeal proceedings the matter reached before the Chennai Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions of Section 56 of the ITA

“....
(2) In particular, and without prejudice to the generality of the provisions of sub-section (1), the following incomes, shall be chargeable to income-tax under the head “Income from other sources,” namely:-

.....
(x) where any person receives, in any previous year, from any person or persons on or after the 1st day of April, 2017,-

(a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum;

(b) any immovable property,-

.....
(c) any property, other than immovable property,-
(A) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;
(B) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration :

Provided that this clause shall not apply to any sum of money or any property received-

.....
(X) from an individual by a trust created or established solely for the benefit of relative of the individual;”

Decision of the ITAT:

The ITAT acknowledged that, *inter-alia*, the question before them was whether the taxpayer trust was created or established **solely** for the benefit of the relatives of the individual i.e. the settler.

² VS Trust vs. Income-tax Officer, Chennai [2026] 182 taxmann.com 842 (Chennai - Trib.)

- Where any property [*shares, in this case*] is received from an individual [*settler, in this case*], by a Trust [*taxpayer, in this case*] which is created or established solely for the benefit of the relative of such individual, then, the provisions of section 56(2)(x) of the ITA will have no application and hence, such receipt of property by the trust will not be liable to income-tax. The language employed in clause (X) of proviso to section 56(2)(x)(c) of the ITA is clear that the benefit of exemption is available only to those trusts established **solely** for the benefit of the relative of the individual. The term 'relative' is defined under explanation (e) to section 56(2)(vii) of the ITA.
- Where any taxpayer trust receives any property from any person, the same is taxable under the ITA. However, only if the 'person' giving the property is an 'individual' and the trust is created or established **solely** for the benefit of the 'relatives' of such 'individual' viz., all the beneficiaries of the trust qualifies as 'relative' of such 'individual' parting with the property, under explanation (e) to section 56(2)(vii); then such receipt of property by the trust will not be taxable under section 56(2)(x) of the ITA.
- The discretion given to the trustees in Clause 5.2* of the original trust-deed suggested that, non-relatives could be later on added to the benefits of the taxpayer trust and therefore it could not be said that the taxpayer trust was created or established solely for the benefit of relatives of the individual.

**Clause 5.2 of the original-trust deed, amongst others, permitted (a) the settler himself to be a beneficiary and (b) empowered the trust to add any entity as a beneficiary which is majority owned or controlled, directly or indirectly, either individually or collectively, by the relatives of the settler.*

- However, the said Clause 5.2 of the original-Trust-deed relied upon by the lower authorities had been substituted and replaced by the supplemental-Trust-deed which was effective from the date of inception of the Trust. As per the same, the trustee(s) may remove any beneficiary by way of a written resolution of the trustee(s), from the benefits of the trust with or without making any distributions of the trust property (subject to certain conditions) to such removed beneficiary. Provided that certain beneficiaries could be removed only with prior written consent of the settler.
- The original trust deed relied upon by the AO and CIT(A) had been substituted and replaced by the supplemental trust deed which was effective from the date of inception of the trust. As per the same, the trustee(s) may remove any beneficiary by way of a written resolution of the trustee(s), from the benefits of the trust with or without making any distributions of the trust property (subject to certain conditions) to such removed beneficiary. Provided that certain beneficiaries could be removed only with prior written consent of the settler.
- The original trust deed expressly permitted the trustees to amend any of the terms of the deed and the only restriction was that the amendment must not result in:
 - the settler regaining power over the trust property,
 - power of disposition of trust property or
 - altering the objects of the trust.
- The clause of the original trust deed as well as the substituted clause of the amended deed [relating to power to make amendments] did not fall within the ken of the restrictions set out in the trust deed. The amendment was also found to be in alignment with the objects of the trust as it was intended to reinforce the objects of the taxpayer trust so created was meant for the benefit of the family members of the settler. The substituted clause did not vest any power back with the settler, nor did it confer any right to dispose off the trust property, nor did it result in alterations of the object of the trust.
- The original trust deed already empowered the trustees to add/remove any beneficiary from the benefits of this trust. Hence, there was merit in the taxpayer's contention that the amendment made to the original

trust deed was valid, authorized by the original trust deed.

- The original trust deed relied upon by the AO to justify the addition, was deleted and substituted by the amendment deed and such amendment was validly made.
- The beneficiaries in the trust deed comprised **solely** of the relatives of the settlor. There was no provision in the relevant clause or in any of the other terms of the trust deed, by virtue of which any minority benefits could possibly accrue to any non-relatives of the settlor. Rather, the taxpayer trust was found to be established solely for the benefit of the relatives of the settlor. The foundational basis of the lower authorities for making the addition stood vacated.

In view of the above the ITAT held that the present case squarely gets covered by the exception set out in clause (X) of proviso to section 56(2)(x)(c) of the ITA, as the taxpayer trust was created only for the exclusive benefit of the relatives including the settlor himself. Accordingly, the addition made by the AO under section 56(2)(x) of the ITA was unjustified and hence deleted.

Comments:

Section 56(2)(x) of the ITA is an anti-abuse provision which taxes receipt of money or property without consideration, or for inadequate consideration, in the hands of the recipient. However, the provision carves out certain exceptions for specific taxpayers including receipts from certain defined 'relatives' thereby recognizing bona fide family arrangements.

In case of a trust arrangement, typically, the property is transferred to the trust by the settler and for the benefit of the beneficiaries. In case any entity is proposed to be the beneficiary, then, it may be relevant to examine who holds interest in such entity and whether they can qualify as relative for the purposes of exclusion under section 56(2)(x) of the ITA.

Further, the mechanics of the trust are defined by the trust deed, which may undergo a change. The ITAT in this ruling considered the amendment to the trust deed while arriving at its finding that the taxpayer trust was created only for the exclusive benefit of the relatives including the settler himself.

The ITAT in this ruling has, *inter-alia*, held the following:

- If the 'person' giving the property is an 'individual' and the trust is created or established solely for the benefit of the 'relatives' of such 'individual', then such receipt of property by the trust will not be taxable under section 56(2)(x) of the ITA.
- The beneficiaries in the trust deed comprised **solely** of the relatives of the settlor. There was no provision in the relevant clause or in any of the other terms of the trust deed, by virtue of which any minority benefits could possibly accrue to any non-relatives of the settlor.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.



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