Bombay Chartered Accountants' Society

Study Course on FEMA

Subject –
FEMA provisions & RBI approach to Private Trust

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Private Trust under FEMA

- Trust is on obligation accepted by the Trustee in respect of property for the benefit of the beneficiaries. But for some purposes it is treated as a person (e.g. Mutual Fund, Charitable Trust).

  Under Income-tax law, Trust is not a person. But funds are given exemption or considered as pass through entities.

  Under FEMA also, there is no clarity – neither of personal status nor of residence. In fact the law is absent.

Split ownership

- Trust has **split ownership** – Legal owner and beneficial owner. Whose status should be considered? No clarity.
- Due to absence of law and desire to use the Trust somehow, Trust issues become complicated.
- Other issues such as assets being in India or abroad, residential status of the trustee and beneficiary add to the complications.

Multiple permutations

- Several situations:
  - Settlor – resident or non-resident.
  - Beneficiary – resident or non-resident.
  - Asset – in India or outside India.
  - Trustee – resident or non-resident.
  - Personal status of the above persons.

- In this presentation, a few important situations are dealt with. For details see article.

Current / Capital Account Transaction

- Settlement in a Trust by an Indian resident settlor, which has non-resident beneficiaries, results in a gift to the beneficiaries. It is a current account transaction [S. 2(j)]. However as it results in an interest in cross border assets by the beneficiary, it is a **Capital Account Transaction** for the beneficiary [S. 2(e)].

- Without a specific or general permission, such settlement cannot be done.

Current / Capital Account Transaction

- A Trust where trustee, beneficiary, settlor, asset (<u>all</u>) are <u>in India</u> or <u>all are outside India</u>, FEMA will not apply.

- A Trust where any of the (trustee, beneficiary, settlor, asset) are not in India, and others are in India - FEMA applies.

Guiding principle

- Guiding principle – What cannot be done directly, cannot be undertaken indirectly through a Trust. (No law. It is a practice as per RBI.)

- One should see the ultimate effect of a transaction and then decide whether transaction is permitted or not.

- In case of doubt, apply to RBI.

Some transactions where FEMA provisions apply

- Indian resident cannot make any payment to or for the credit of a non-resident [S. 3].
- Payment under LRS is permitted – only as specified.
- Creating an interest in favour of a non-resident [S. 2(e) – Capital Account Transaction].
- Receipt of foreign assets by an Indian resident cannot be held outside India [Ss. 4 and 8].
- Investment in India is not permitted by an "unincorporated body" (trust is "unincorporated").

Situation 1

Indian resident settlor

Indian Trust

Indian assets

Non-resident beneficiaries

RBI view

- Communication from RBI…

2. In this connection, we advise that as far as formation of trust in India by the Indian resident citizens with NRI/ PIO/ Foreign national as its beneficiaries is concerned, no permission from the Reserve Bank of India is required. However, the trust should not acquire the assets which have been prohibited to be acquired by the NRI/Foreign national/PIO under extant FEMA provisions.

- On further discussions, RBI says settlement upto LRS limit is all right! In fact as per RBI, if settlor and Trustee are Indian residents, FEMA does not apply.

RBI view means…

- No approval for settlement.
- No limit on settlement.
- Foreigners also can be beneficiaries.
- Only restriction is on investment by Trust.
- No other conditions.

- Can assets worth Rs. 100 cr. be settled? No.

Some FEMA Issues involved

- Indian settlor wants to settle Indian Trust with Indian assets. Beneficiaries are NRIs.
- FEMA rules which can apply for gift:

  - Gift to non-resident – upto LRS limit.

  - Gift in rupees only to relatives (as per Companies Act) in NRO account.

  - Gift under LRS has to be in money.

  - Compliance for LRS.

  - For shares, the limit is 5% cumulative limit and upto US$ 50,000 per year.

  (On settlement, the above rules cannot be complied with – except gift in money.)

RBI approval

a) The non-resident beneficiaries should not undertake any transaction such as acquire, transfer, or repatriate any asset/sale proceeds through the trust, which he/she is otherwise not eligible to do.

b) Any remittance outside India of sale proceeds or income of the trust's assets during the lifetime of the settlors should be within the limits prescribed under Liberalised Remittance Scheme for resident individuals, subject to payment of applicable taxes.

c) On demise of the settlors, the assets of the trust shall be distributed to the non-residents as per the terms of the Trust deed and remittances outside India would be subject to the provisions of Foreign Exchange Management (Remittance of Assets) Regulations 2016.

Representation to RBI

2. In this connection, it is advised that where assets are transferred/ settled through a trust structure and a cross border angle is involved, it must be ensured that transactions/ remittances undertaken through the trust, shall not, in any way, circumvent/contravene the extant provisions under FEMA,1999. Further, the trust/its trustees and beneficiaries should not derive entitlement not available to them under the extant provisions of FEMA i.e. what is not permitted to be done directly under FEMA, 1999 should not be done through a trust structure.

- We are continuing our representation.

Trust through a Will

- Inheritance by Trust is permitted through a Will.
- However this is more by practice. Tomorrow RBI may take a view that approval is required.
- Better to take RBI approval.

Situation 2

Indian resident settlor

Foreign Trust

Funds remitted abroad under LRS

Resident beneficiaries

Issues involved

- Prima facie funds can be settled in foreign trust under LRS.
- However can resident beneficiaries be permitted?
- Any asset acquired by the resident, has to be brought into India [Sections 4 and 8].
- Under LRS, gift by one resident to another resident is not permitted. Hence foreign trust with Indian beneficiaries cannot be formed.

Foreign Trust – Resident beneficiaries

- Even if it is a discretionary Trust – debatable whether it can be settled. Better is to apply to RBI.
- Only if beneficiaries are non-residents, it is all right.
- If the foreign Trust has Indian resident trustees, there will be difficulties in owning foreign assets.

Situation 3

Non-resident settlor

Foreign Trust

Foreign assets

Resident beneficiaries

Non-resident settlor – Foreign Trust

- Indian resident beneficiary is required to bring back the funds.
- If it is discretionary trust, Indian resident beneficiary cannot bring the funds.

  In this case, be prepared for tax scrutiny, litigation & Enforcement proceedings. Rest assured that under Automatic Exchange of Information, your transactions will be known to GOI.

  Better to approach RBI for approval / directions.

Thank you.
Questions and comments are welcome.

For more discussion on various subjects, visit our website – www.rashminsanghvi.com

Thanks for contribution by CA Mr. Rashmin Sanghvi and CA Rutvik Sanghvi

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