

EY Tax Alert

**Mumbai Tribunal Special Bench
rules determination of maximum
marginal rate for private
discretionary trust with
surcharge at graded rate**

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Executive summary

This Tax Alert summarizes a Mumbai Tribunal (Tribunal) Special Bench (SB) decision dated 9 April 2025, in the case of Araadhya Jain Trust¹ (Taxpayer), wherein an issue arose on the applicable rate of surcharge while determining maximum marginal rate (MMR) to income earned by a private discretionary trust (DT).

In this case, the Taxpayer, a private DT, offered income to tax at MMR as per the provisions of the Indian Tax Laws (ITL) by considering the highest rate of income tax, but without surcharge, as the total income of the DT fell below the threshold for levy of surcharge. However, the Centralised Processing Centre (CPC), while processing the return of income, levied MMR by using the highest rate of surcharge.

The Tribunal disagreed with the approach of the CPC and, after considering the detailed arguments, ruled in favor of the Taxpayer. It held that, while determining MMR applicable to DTs, the highest income tax slab rate as applicable to individuals is to be adopted, whereas surcharge is to be considered in a graded manner depending upon the level of total income.

¹ Araadhya Jain Trust v. ITO (ITA No. 4272/Mum/2024) dated 9 April 2025



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Background

- ▶ A private DT is generally registered as a trust under the Indian Trust Act, 1882, wherein either the beneficiaries are not known, or their shares are not ascertainable. The trustee has the discretion to decide the class of beneficiaries who can receive either capital or income from the trust. No beneficiary has absolute entitlement, either to income or capital, and their share remains indeterminate.
- ▶ The ITL mandates that a trustee who receives income on behalf of any other person would be assessed as a representative assessee (RA) for and on behalf of such a person. The RA is subject to the same duties, responsibilities and liabilities as if the income accrues to them.
- ▶ The ITL provides for a special rate of tax where individual shares of the beneficiaries are indeterminate or unknown². Income of such DT is taxable in the hands of the RA at MMR. The ITL defines MMR as the rate of income tax (including surcharge on income tax, if any) applicable in relation to the highest slab of income in case of an individual, association of persons (AOP) or, as the case may be, as specified in the Finance Act (FA) of the relevant year.
- ▶ Every year, the FA provides the rate of tax and surcharge applicable for all categories of taxpayers like individuals, Hindu Undivided Families, companies, AOPs etc. The surcharge depends on the level of income and the category of the taxpayer.

Facts of the case

- ▶ During tax year 2022-23, the Taxpayer earned an income of INR0.4m on which it applied the highest income tax rate as prevalent for the said tax year (i.e., 30% on total income of INR1m and above), but did not consider the surcharge since the income was below the threshold for applicability of surcharge. (i.e., 37% on total income exceeding INR50m).
- ▶ The CPC, while processing the return of income, carried out adjustment and applied the highest rate of surcharge while determining MMR i.e., income tax rate of 30% under the ITL and imposed a 37% surcharge (as applicable to the highest slab of income exceeding INR50m). The first appellate authority (FAA) confirmed the tax rate applied by the CPC. Aggrieved, the Taxpayer filed an appeal before the Tribunal.

- ▶ The Division Bench (DB) of the Tribunal followed its own decision³ in the case of the Taxpayer rendered for an earlier tax year of 2021-22. In that case, the DB had held that the DT shall be taxed at MMR which shall be arrived at by taking the highest rate of income tax and the highest rate of surcharge applicable in case of an individual, irrespective of quantum of income. The DB arrived at such a conclusion after taking into consideration various decisions⁴ in the context of taxation of DTs and also the anti-abuse intent of the legislature while introducing tax rate of MMR for DTs.
- ▶ In view of divergent judicial precedents, the matter was referred to an SB of the Tribunal.

Tax authority's arguments

- ▶ MMR for a particular year is based on rates provided in the FA for every tax year. As per legislative intent, provisions of the ITL were amended in the year 1980 to levy tax on income of DTs at MMR as a measure to curb tax avoidance. In view thereof, the income of the DT should be taxed at the highest rate of income tax, as well as rate of surcharge which is applicable for the highest slab of income.
- ▶ Reliance was placed on a Supreme Court decision in the case of Gosar Family Trust v. CIT⁵ to argue that the policy of the law under the provisions of the ITL to tax income of a DT at MMR, is to discourage formation of DTs.
- ▶ Referring to the definition of MMR under the ITL, which reads as *"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, as specified in the Finance Act of the relevant year;"*, it was contended that the scope of the term "if any" is to ascertain whether the FA has levied surcharge for that particular tax year or not. For instance, in tax year 2009-10, 2010-11, no surcharge was levied; in that case, MMR would have been determined without addition of surcharge.
- ▶ MMR contemplates the highest rate of surcharge⁶. If a different rate of surcharge for different kinds of taxpayers and for different slabs of income as provided in the FA is applied for DTs, then the definition of MMR shall become otiose.

Taxpayer's arguments

- ▶ The levy of tax and surcharge are governed by the provisions of the FA enacted every tax year. Therein, the income tax rates are provided basis the slab of income for certain categories of non-

² As per the ITL, individual shares of the beneficiaries are indeterminate or unknown if the same are not specified in the trust deed and are not ascertainable as such as on the date of execution of the trust deed.

³ [TS-741-ITAT-2024 (Mum)]

⁴ CIT v. C.V. Divakaran Family Trust [(2002) 254 ITR 222 (Ker.)]; Gosar Family Trust, Jamnagar etc. v. CIT dated 28 April

1994 (MANU/SC/0316/1995); CIT v. JK Holdings [(2003) 133 Taxman 443 (Bombay)]

⁵ [(1995) (81 Taxman 146) (SC)]

⁶ Anant Bajaj Trust v. DDIT (in ITA No. 199/Mum/2024); Araadhya Jain Trust v. ITO (ITA No. 2197/Mum/2024); Kapur Family Trust v. ITO (ITA Nos. 3834 & 3835/Mum/2024)

corporate taxpayers and rate of surcharge is levied on tax and is determined based on the level of income. For instance, under FA, 2023, 30% income tax rate is applicable where total income of a taxpayer is INR1m or more, surcharge of 10% is applicable for total income exceeding INR5m and 37% surcharge is applicable for total income exceeding INR50m.

- ▶ The scheme of the ITA suggests that due to specific provisions of the ITL, the rate of income tax i.e., MMR shall be applicable for DTs. The normal income tax rate applicable with reference to slabs of income is, therefore, not applicable for DTs. The expressions “rates of income tax” and “surcharge” in the FA carry different connotations and are reflected distinctly. Surcharge is recognized as a separate category and its collection is treated differently. Given that, unlike in relation to tax rate, there is no legal fiction created in relation to surcharge, the surcharge rate as applicable to respective categories of taxpayers and the level of income as provided in the FA should alone be applicable.
- ▶ The highest rate of surcharge should apply only if the total income exceeds INR5m, as per the FA. Reliance was placed on various Tribunal decisions⁷ for the same.
- ▶ In the definition of MMR under the ITL, the word “if any” succeeding the expression “including surcharge on income tax” suggests that surcharge levy be considered if applicable. As per the provisions of the FA, no surcharge is leviable if the income of the taxpayer does not exceed a specified limit. Where income exceeds such limit, the FA provides for different rates of surcharge depending upon the quantum of income, nature of income or the category of the taxpayer.
- ▶ The term “including surcharge on income tax, if any” in the definition of MMR does not mandate the highest surcharge rate, but incorporates surcharge as per the FA basis the slab structure.
- ▶ Surcharge was introduced⁸ with an intent to augment the nation’s developmental activities by generating additional fund through levy. The levy of surcharge, as well as the rate at which it has to be levied, has a direct nexus to the quantum of income earned by a taxpayer. The surcharge cannot be levied by giving a complete go-by to the threshold limit of income. Applying the 37% surcharge to DTs with income of INR0.4m would defeat the purpose of slab-based surcharge and create discrimination.
- ▶ The definition of MMR has to be given contextual interpretation to avoid absurdity. Tribunal decisions taking contrary views have no precedential value,

as the same were recalled later and/or relied on recalled decisions.

- ▶ The DB decision rendered in the Taxpayer’s own case for earlier tax years does not lay down the law correctly since it relied on judicial precedents which did not deal with the issue of levy of surcharge at all while determining MMR.
- ▶ In case of conflicting views, the view which is favorable for the Taxpayer should be preferred.

Tribunal’s ruling

The SB accepted the Taxpayer’s contentions and held that in the case of private DTs whose income is chargeable to tax at MMR, surcharge has to be computed on the income tax in a graded manner basis the level of total income applicable as per the FA, and not at highest surcharge rate. The Tribunal reasoned as under:

- ▶ The ITL provisions dealing with taxation of DTs state that income is taxed at MMR. The definition of MMR under the ITL refers to the rate of income tax applicable to the highest slab of income as provided under the FA of the relevant tax year. Neither the special provision nor the definition of MMR specifies the tax rate or surcharge.
- ▶ The meaning of the term “slab” was not defined under the FA. The Tribunal referred to a circular and a press note⁹ issued, wherein it is stated that the expression “slab” referred to “income” and not the tax. Consequently, in the given financial year, the tax rate applicable to the highest slab of income was 30%. Thus, MMR is 30% to begin with.
- ▶ The FA requires that the tax so worked out be increased by surcharge calculated in the manner provided therein. It then provides different rates of surcharge in the range of 10-37% with reference to the level of income of the taxpayer. An exception is also created in respect of income by way of dividend or certain capital gains income where surcharge is prescribed at a rate of 10% and a maximum of 15% depending on the level of income. Consequently, the argument of the tax authority that the highest rate of surcharge is applicable irrespective of the level of income or nature of income, will make these provisions of surcharge as applicable to specified income and income-linked surcharge rates otiose for DTs. Such construction will lead to undesirable consequences and will be discriminatory.
- ▶ The expression “including surcharge on income tax, if any” that is used in the definition of MMR under

⁷ ITO v. Tayal Sales Corporation [(2003) 1 SOT 579 (Hyd.)]; Lintas Employees Professional Development Trust v. ITO (ITA No.4791/Mum/2023); Sriram Trust v. ITO (ITA Nos. 439, 440 & 441/Hyd/2024); Ujjwal Business Trust v. CPC (ITA No. 602/Mum/2024); Lintas Employees Holiday Assistance Trust v. CPC (ITA No. 1796/Mum/2024); Jitendra Gala Navneet Trust v. DDIT and Dilip Sampat Navneet Trust v. DDIT (ITA Nos. 2484

& 2485/Mum/2024); Lintas Employees Holiday Assistance Trust v. ITO (ITA No. 3949/Mum/2024); V. Meera Charitable Trust v. ITO (ITA No. 2140/Chny/2024)

⁸ Hon’ble Finance Minister’s budget speech for tax year 2019-20 delivered on 5 July 2019

⁹ Press Note dated 1 December 1965, Circular No. 2/2018 (F. No. 370142/15/2017-TPL)

the ITL, shall mean the surcharge depending on the level of income as provided in the FA.

- ▶ Responding to the tax authority's argument that the term "if any" under the definition of MMR refers to the case where the FA of the relevant tax year has not levied the surcharge, the SB stated that levy of surcharge can only be under the authority of law as enacted. In the absence of such an authority, surcharge cannot be collected at all. In the light of this legal position, it is not correct to suggest that the use of "if any" in the definition of MMR represents cases of those FAs where there is no levy of surcharge.
- ▶ Consequently, the expression "if any" used in the definition of MMR requires to be read in the context of a graded level of computation mechanism provided under the relevant FA for levy of surcharge, including cases where no surcharge is applicable for a particular level of income.
- ▶ The levy of surcharge depending on the level of income is also supported by the legislative intent of asking persons in the highest income bracket to contribute a little more than other citizens for nation building.
- ▶ The SB also negated the DB's decision in the Taxpayer's own case for an earlier year, which had relied upon certain High Court (HC) decisions, since the HC decisions did not deal with the issue of applicability of the highest rate of surcharge in the case of DTs. The SB, however, upheld the favorable decisions relied upon by the Taxpayer in the context of applicability of MMR to DTs.

Comments

The SB decision is welcome and provides relief to DTs. It has adopted a pragmatic approach in determining the rate of surcharge depending on the level of income of a DT and in approving the levy of a graded surcharge rate in consonance with the provisions of the ITL.

The SB decision may benefit the DTs whose income level for a given year is less than the threshold, triggering the highest surcharge rate.

Taxpayers may face practical challenges in implementing the SB decision if the CPC does not appropriately modify the online utility for filing and processing returns of income.

Besides DTs, the concept of MMR under the ITL applies also to other categories of taxpayers such as AOPs. MMR also applies to certain categories of income of entities such as charitable trusts (on exit tax levy), business trusts (income other than specific capital gains). The ratio of the SB decision may also hold good to determine MMR in such cases as well.

A SB is generally constituted when there are conflicting decisions of the Tribunals or the matter pending for adjudication is of considerable importance. It is also a well-settled convention to consider the SB decision as binding on the DBs of the Tribunal.

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