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Delhi High Court affirms the determinate trust characterisation for Category III AIFs

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A Division Bench of the Hon'ble Delhi High Court in a writ petition involving Equity Intelligence AIF Trust (the Fund) ruled that a Category III Alternative Investment Fund (AIF) shall be treated as a determinate trust insofar as the identity of the investors and their respective shares are set out in the contribution agreements (see Equity Intelligence AIF Trust v CBDT and Anr, 2025:DHC:6170-DB).

The Court examined whether the requirement in the Circular dated 28 July 2014 issued by the Central Board of Direct Taxes (CBDT Circular) requiring a trust deed to specify the investors names and their respective beneficial interests for a trust to be recognised as determinate in nature is contrary to the SEBI regulations as well as jurisprudence on this subject.

Background

- As per the trust taxation provisions under Income Tax Act, 1961, if the investors in a trust are identifiable with their respective share of income, tax is levied at the rate applicable on relevant income streams. However, an indeterminate trust is taxed at the maximum marginal rate.

- In this case, the Fund was set up in the form of a trust and registered as an open-ended Category III AIF with the Securities and Exchange Board of India (SEBI) for investment in listed equity shares. The identity of the investors in the Fund and their share in the income of the Fund was captured in the respective contribution agreements (and not in the trust deed).

- In 2018 the Fund approached the Authority of Advance Ruling (now substituted with the Board of Advance Ruling) for advance ruling on various issues. In 2021 the Board of Advance Ruling (BAR) ruled that as the investors and their respective shares are not identified in the trust deed, the Fund shall be treated as an indeterminate trust and taxed at the maximum marginal rate.

- Aggrieved by the aforesaid ruling, the Fund challenged BAR's ruling before the Delhi High Court to declare the CBDT Circular as ultra-vires the provisions of Income Tax Act, 1961 and to quash the order passed by BAR.

High Court Ruling

Ruling in favour of the Fund and quashing the order passed by BAR, the Delhi High Court concluded that once the investors are identified with their respective shares, a trust shall be treated as determinate in nature. Key findings of the High Court are as set out below:

- SEBI (Alternative Investment Funds) Regulations, 2012 (SEBI AIF Regulations) prevents an entity from acting as an AIF and accepting any investment, unless it procures the certificate of registration from SEBI. For seeking the registration, the applicant entity is required to register the trust deed under the provisions of Registration Act, 1908. Accordingly, imposing an obligation on a fund to identify the investors in the trust deed is in clear violation of the SEBI AIF Regulations making it impossible to comply with requirement under the CBDT Circular.

- Referring to the decision of Karnataka High Court in the case of India Advantage Fund-VII (2017) and the Madras High Court in the case of TVS Shriram Growth Fund (2020), the Delhi High Court agreed that so far as the investors are identified with their respective share (though not mentioned in the trust deed), the trust shall be determinate in nature.

- The paragraph 6 of the CBDT Circular stating that the requirement to specify the investors in the trust deed shall not apply in the area in which the jurisdictional High Court adopts a different view is contrary to the settled position in law. If an issue has been decided by a Constitutional Court, it is binding on the tax department, unless such decision has been set aside or challenged by a higher constitutional court.

- The CBDT Circular should read down in the manner interpreted by the Court.

Comments

The decision of Delhi High Court underscores the well settled position that the tax department cannot impose requirements which conflict with compliance under other regulations. So long as investors in an AIF are identified with their respective shares this would not impact the characterisation of the trust as a determinate trust. This would greatly benefit the AIF industry including open-ended funds, where there is a frequent churn of investors.

In case of a determinate trust, the investment income is taxed at the rate applicable to the relevant investor. However, if the trust earns business income, the maximum marginal rate could still apply. This requires an AIF to review and ensure the investment strategy, conduct, and mechanics are aligned to achieve the objective of capital appreciation.

- *Rahul Jain (Partner) and Naveen Keshwani (Associate)*

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