

Indirect Tax Flash Alert

20 February 2024

Service, if any rendered, by an Investment Trust is for its own self

- Previously, in **ICICI Econet Internet and Technology Fund and Others vs. Commissioner of Central Tax, Bangalore North**¹ case, the Bangalore Customs Excise and Service Tax Appellant Tribunal (“CESTAT”) in the context of the relationship of a trust with its investors had held that trust registered under the Regulations is a juridical person for the purposes of SEBI Regulations and should be treated as the same for tax purposes too. The CESTAT had observed that Trusts by concerning themselves in commercial activities and by using the discretionary powers to benefit a certain class of investors or nominees or employees or subsidiaries, have violated the principles of mutuality and therefore cannot be treated as trusts for the purposes of taxation statutes.
- The CESTAT while disregarding the pass-through status of the trust, had further held that Trust / Venture Capital Funds (VCFs) exist and function as juridical persons as far as they are rendering services exigible to tax as per the provisions of the Finance Act, 1994 notwithstanding the treatment meted out to them under different statutes. An appeal was filed against this decision of the CESTAT before the Karnataka High Court.
- The Karnataka High Court vide its judgment dated 08 February 2024² has set-aside the aforesaid decision of CESTAT and has allowed the assessee’s appeal based on following questions of law –

¹ Final Order No. 20372-20402/2021 dated 07.07.2021 passed by CESTAT

² Final Order dated 08.02.2024 passed for CEA No. 20/2021 and other connected matters by Karnataka HC

- **The appeal is maintainable before the High Court**

The High Court has held that since the issue involved in the present case is not one of rate of duty and that of taxability, an appeal would correctly lie before the High Court and hence the appeal was maintainable before the High Court.

- **Trust is not recognised as a distinct person under the Finance Act, 1994 and therefore cannot be treated as a juridical person**

The High Court observed that the definition clauses of each statute must be read with the object and purpose of that statute only as intended by the legislature. Unlike various other statutes such as SEBI, GST, and IBC which recognise trust as a 'person', the Finance Act, 1994 does not recognize 'trust' as a distinct 'person'. Accordingly, the CESTAT's view that the trust shall be treated as a juridical person for taxation is untenable.

- **Pass-through status of the Appellant shall be recognised for taxation purposes**

Having regard to the transaction details of the entire fund management, the High Court observed that the assessee acts as a trustee holding the money belonging to contributors to be invested as per the advice of the investment manager. The High Court recognised that the assessee acts as a 'pass through' wherein funds from contributors are consolidated and invested by the investment manager and all the returns / profits generated are all passed on to the contributors, without the fund retaining any part of these returns / profits. Accordingly, the High Court held that the fund merely acts in the capacity of a trustee and holds the belonging to the contributors and does not provide any service to its contributors, and therefore, imposition of Service tax is untenable.

- **The asset management service, if any rendered, is by the Appellant for its own self –**

The Hon'ble High Court observed that in the instant case the contributors (institutional investors) and the trust cannot be dissected as two different entities as the contributor's investment is held in trust by the fund. The Trust does nothing more than holding such funds and investments (if any) are all as per the advice of investment manager. Hence, there is no distinct supply by the Trust to the contributors as there can be no service to self.

Aurtus comments:

- The said judgement recognises the pass-through status of the VCFs / AIFs / other similar structures while managing the contributions from investors and reinforces the existence of principle of mutuality while managing monies through trust structures. The judgement therefore is in line with the provisions of the Finance Act, 1994 which mandate the existence two separate persons [i.e. service provider and service recipient] and consideration to establish the provision of services.

- As regard the taxability of the said structures under the GST regime, a Trust is included as a separate person u/s 2(84) of the CGST Act, and therefore the principle of mutuality between the Trust and its contributors would not be a strong ground under GST. However, a mere inclusion of a 'Trust' in the definition of a 'person' would not by itself create a supply between the investors settlers and the Trust. In the absence of any supply, and given the pass-through status of trusts, no GST liability can be fastened on a Trust for any manner of facilitation to its investors, as it is not independent of its investors. Given this, it is important that the Trust documents clearly bring out the pass-through status of the Trust.
- In this regard, the Trust Deed and the Private Placement Memorandum, especially the clauses on payment reimbursement of expenses should clearly bring out that there is no independent supply by the Trust to its investors, and that the payments made to investment managers are on behalf of investors.

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