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**[2025] 173 taxmann.com 996 (Article)**

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**Surcharge on income of a private discretionary trust must be calculated based on slab rates outlined in the Finance Act – Mumbai Tribunal (Special Bench)****BIJAL AJINKYA**

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In *Araadhya Jain Trust v. ITO* [2025] 173 taxmann.com 343 (Mum. - Trib.)(SB), a Special Bench of the Income Tax Appellate Tribunal, Mumbai (ITAT) took a view that the rate of surcharge applicable to a private discretionary trust whose income is taxed at the maximum marginal rate (MMR), should be computed with reference to the slab rates specified in the Finance Act of the relevant year under the heading 'Surcharge on Income Tax'. The judgment was passed by the Special Bench in a group of matters on the same issue.

**Background**

- The Taxpayer is a private discretionary trust who filed its income tax return (ITR) for Assessment Year 2023-24 declaring a total income of INR 4,85,290. As per the provisions of section 164 read with section 2(29C) of the Income Tax Act, 1961 (IT Act), the taxpayer paid tax at MMR. However, the ITR was processed by the Central Processing Centre, levying the highest rate of surcharge of 37% on the MMR at which tax was computed.
- The appeal was decided against the taxpayer by the first appellate authority and by the ITAT. The ITAT held that as per section 164 read with section 2(29C) of the Act, which defines MMR, the rate of surcharge would be the highest rate of surcharge provided under the Finance Act, irrespective of the quantum of income.
- The taxpayer then applied to ITAT to set up a Special Bench to express a view on the issue because while ITAT had taken a similar view on the issue in *Anant Bajaj Trust v. Dy. DIT* (unreported judgment in [IT Appeal No. 1995 (Mum.) of 2024, dated 26-8-2024) ITAT later recalled this decision. Hence there was no clarity on the issue in the absence of a view from ITAT or a higher court. Pursuant to the constitution of the Special Bench, various intervention applications were also filed and heard by the Special Bench.

**Taxpayer's contention**

- As per section 164 read with section 167B of the IT Act, the income of a private discretionary trust is to be taxed at MMR, which is defined in section 2(29C) of the IT Act. MMR as per section 2(29C) of the IT Act means the rate of income tax applicable in relation to the highest slab of income as specified in the Finance Act of the relevant year and such tax is to be increased by surcharge, if any.
- The slab rates applicable are provided in section 2(1) of Finance Act, which is subject to sub-sections (2)

and (3). However, section 2(3), which refers to section 164 and section 167B of the IT Act, refers to the rate of tax and does not refer to the rate of surcharge. Therefore, the slab rates mentioned in section 2(1) of the Finance Act are modified by sub-sections (2) and (3) only in relation to the rate of tax, and not in respect of the surcharge.

- A perusal of the First Schedule of the Finance Act shows that it distinguishes between 'rates of income tax' and 'surcharge on income tax' as the Finance Act specifically refers to 'rates of income tax' and 'surcharge', rather than 'rates of surcharge'. Surcharge is thus an additional amount levied over and above the income tax.
- Section 2(3) of the Finance Act only refers to the rate of tax for the purposes of section 164 and section 167B of the IT Act and not for the purposes of surcharge. As far as surcharge is concerned, the charging provision is in section 2(1) of the Finance Act, 2023 refers to the First Schedule and prescribes the levy of surcharge based on slab of income. This implies that the highest surcharge rate of 37% is applicable only when the income exceeds INR 5 crores. Accordingly, unless the income crosses the threshold limit of INR 5 crores, the surcharge at the highest rate of 37% is not applicable.
- The phrase "including surcharge on income-tax, if any," is placed in round brackets in the definition clause of MMR under section 2(29C) of the IT Act, which indicates that it serves as supplementary information, distinct from the core context of the definition. Therefore, it would be inappropriate to interpret it as authorizing the levy of surcharge at the highest rate.
- Surcharge is computed over and above the income tax as computed as per the rates of tax specified under Paragraph A of Finance Act, 2023. Certain provisions of the IT Act provide levy of tax at special rates or MMR, which only deals with the levy of rate of tax and not surcharge.

### **Special Bench Ruling**

- The tax on the total income of a private discretionary trust must first be computed by applying the maximum marginal rate applicable to the highest slab of income for an individual, AOP, or BOI as per the Finance Act for that year. Only thereafter, if applicable, the surcharge is to be calculated on the determined income tax.
- A conjoint reading of sections 164 and 167B of the Act shows that tax is to be computed at the MMR, but there is no mention of surcharge. While section 2(29C) of the IT Act includes surcharge in the definition of MMR, section 2(29C) does not itself prescribe the rate of surcharge; instead, section 2(29C) refers to the rates specified in the relevant year's Finance Act. Therefore, the applicable MMR must be determined based on the rates provided in the Finance Act for a particular year.
- After referring to Paragraph A, Part (I) First Schedule of Finance Act, 2023, the Special Bench concluded that that maximum marginal rate of tax as per section 2(29C) of the IT Act will be 30% as applicable to the highest slab of income. 'Slab' is not used either in section 2(2) or in Paragraph A, Part I of the First Schedule to the Finance Act, 2023. 'Slab' refers to income and not 'tax'. Thus, in terms of sections 164 and 167B read with section 2(29C) of the IT Act, tax as per MMR would mean 'the rate of tax applicable to the highest slab of income' under Item (1) of Paragraph A, Part (I) of First Schedule to the Finance Act, 2023 and not highest slab of surcharge.
- Under the heading 'Surcharge on income-tax' in Paragraph A, Part I of the First Schedule, it is provided that the income tax computed under various provisions shall be increased by a surcharge, calculated based on the taxpayer's category. Items (a) to (e) specify varying surcharge rates depending on the type of income. The first proviso under the heading 'Surcharge on income tax' carves out an exception regarding the rate of surcharge by stating that in case of dividend income or income under the provisions of section 111A, 112A and section 112A of the IT Act, the rate of surcharge on the amount of income tax computed on that part of income shall not exceed 15%. Thus, if the contention of the Revenue that surcharge is to be applied at the highest rate of 37% irrespective of the quantum of income of a private discretionary trust is accepted, then the exception provided in the first provision under the heading 'Surcharge on income tax' would become otiose.

### **Comments**

The issue of the applicable rate of surcharge for a private discretionary trust whose income is taxed at MMR is under consideration before various tax authorities and courts. The Special Bench considered the relevant provisions of the

Finance Act and took a view that surcharge is always computed over and above the amount of income tax, depending on either the rate provided in the Finance Act for that year or as per the relevant provisions of the IT Act.

Interestingly, there are certain other provisions in the IT Act which impose tax at MMR such as section 115TD (exit tax' in case of non-profit organizations in certain situations). For such category of income, section 2(4) of Finance Act states that tax on such income is to be further increased by a surcharge of 12% of such tax. If MMR includes the highest rate of surcharge, then these provisions will become otiose.

This is a positive ruling for a private discretionary trust whose income is taxed at maximum marginal rate. The Special Bench has taken a view that MMR means the highest rate of tax on income, viz, 30% and it does not include the highest rate of surcharge on such tax. The applicable rate of surcharge will be the rate as per the Finance Act of the relevant year depending on the type of assessee, quantum and category of income.

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