CORPORATE INSOLVENCY AND TRUST LAWS IN INDIA

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ABSTRACT

The interplay between corporate insolvency and trust laws in India is a critical area of legal inquiry, particularly in light of contemporary global economic challenges and cross-border financial complexities. This research explores the protection of trust assets during insolvency, ensuring their segregation from corporate assets to safeguard beneficiaries' interests. It examines the contentious priority between trust beneficiaries and corporate creditors, highlighting judicial interpretations that often favour beneficiaries while addressing the broader goals of insolvency laws. The study delves into the tracing of misappropriated trust assets, drawing on common law principles to navigate the complexities of asset recovery, especially in cross-border scenarios. Corporate trustees' fiduciary duties during insolvency are scrutinized, emphasizing the need for transparency and ethical conduct amidst conflicts between creditor and beneficiary obligations. The doctrines of Quistclose and constructive trusts are explored as unique remedies, offering mechanisms to address specific-purpose loans and unjust enrichment in insolvency cases. Additionally, the research considers the management of cross-border trusts in insolvency, analysing the partial adoption of the UNCITRAL Model Law in India and its implications for harmonizing international legal frameworks. By addressing these nuanced themes, this research project aims to propose adaptive legal frameworks that uphold the principles of equity and justice in an increasingly interconnected global economy.

Keywords: corporate insolvency, trust assets, beneficiaries' interests, cross-border insolvency, fiduciary duties, doctrine of quistclose

1. INTRODUCTION

Corporate insolvency often brings to the forefront complex questions about the treatment of trust assets. In India, the interplay between trust laws and insolvency law poses unique challenges, especially concerning the protection of beneficiary's rights and creditor's claims. Trusts, governed by the Indian Trusts Act, 1882, are legal arrangements where one party holds assets for the benefit of another. However, when a corporate entity acting as a trustee becomes insolvent, the situation often necessitates a nuanced approach to balance the rights of trust beneficiaries against the claims of corporate creditors.

India's insolvency framework, primarily encapsulated in the Insolvency and Bankruptcy Code, 2016 (IBC), provides a mechanism for resolving the debts of insolvent companies. However, the IBC does not explicitly address the treatment of trust assets during corporate insolvency proceedings. This gap requires reliance on established principles of trust law, judicial precedents, and analogous provisions in insolvency law to safeguard trust assets and resolve conflicts between beneficiaries and creditors.

The interplay of these legal regimes raises critical questions about the priority of trust claims, the duties of corporate trustees in insolvency, and the tracing of misappropriated trust assets. Judicial interpretations, such as those in *IDBI Trusteeship Services Ltd. v. Hubtown Ltd*[1], highlight the evolving nature of these issues within the Indian legal landscape. Furthermore, concepts such as Quistclose trusts and constructive trusts, though primarily derived from common law jurisdictions, have found application in Indian jurisprudence, shaping the resolution of trust-related disputes in insolvency scenarios.

In an increasingly globalized economy, cross-border insolvency and its impact on trust assets also present significant challenges. India's adoption of the UNCITRAL Model Law on Cross-Border Insolvency through draft legislation further underscores the need to address trust-related issues within the framework of international insolvency proceedings[2].

The research examines the legal framework and practical complexities surrounding corporate insolvency and trust laws in India. It focuses on safeguarding trust assets, prioritizing the rights of beneficiaries over creditors, tracing trust property, defining the obligations of corporate

[1] 2017 (1) SCC 568; AIR 2016 SUPREME COURT 5321

[2] Government of India, Ministry of Corporate Affairs, Insolvency Section File No. 30/27/2018, Dated: 20.06.2018, Public Notice, available at https://www.mca.gov.in/Ministry/pdf/PublicNoiceCrossBorder_20062018.pdf (last visited on January 20, 2025)

trustees, and addressing the effects of cross-border insolvency on trust structures. Through an analysis of Indian statutes, judicial precedents, and comparative perspectives, the study aims to provide a detailed insight into the intersection of corporate insolvency and trust laws in the Indian context.

2. PROTECTION OF TRUST ASSETS IN INSOLVENCY

In India, safeguarding trust assets during insolvency proceedings necessitates a comprehensive understanding of the interplay among the Indian Trusts Act, 1882, the Insolvency and Bankruptcy Code, 2016 (IBC), and the Companies Act, 2013. Trust assets are distinct in nature, as they involve the separation of legal ownership, held by the trustee, from the beneficial interest, which belongs to the beneficiaries. The legal framework in India is designed to uphold this distinction, ensuring that trust assets remain protected from claims arising out of insolvency proceedings initiated against the trustee or the settlor.

The interplay of these laws not only reinforces the fundamental nature of a trust but also protects the rights of beneficiaries in complex insolvency scenarios. It ensures that trust arrangements continue to serve their intended purpose—preserving the integrity of assets for the benefit of designated parties, even amidst financial distress or insolvency.

2.1. Trust Assets under the Indian Trusts Act, 1882

The Indian Trusts Act, 1882, forms the cornerstone of trust laws in India. Section 10 of the Act mandates trustees to hold and administer trust property exclusively for the benefit of the beneficiaries. Importantly, Section 11 restricts the trustee from utilizing trust property for purposes other than those specified in the trust deed. This segregation of trust assets from the trustee's personal estate ensures that such assets remain insulated from claims by creditors of the trustee.

Furthermore, Section 56 of the Act provides that trust property cannot be attached in execution of a decree against the trustee, reaffirming its distinct and protected status. These provisions collectively fortify the principle that trust assets are not part of the trustee's insolvency estate.

2.2. Insolvency and Bankruptcy Code, 2016

The IBC is an umbrella legislation that governs insolvency and bankruptcy proceedings in India and reinforces the protection of trust assets through its provisions. Section 36 of the Code explicitly excludes assets held in trust from the liquidation estate of a corporate debtor. The explanation to Section 36(4) clarifies that property held in trust for any third party does not form part of the liquidation estate and is not available for distribution to creditors.

This provision serves a critical role in maintaining the integrity of trust property during insolvency proceedings. The rationale behind this exclusion lies in the fundamental principle of trusts—that the legal ownership of trust property rests with the trustee only in a fiduciary capacity, while the beneficial interest belongs to the beneficiaries. Consequently, creditors of the corporate debtor cannot lay claim to assets that do not belong to the debtor but are held in trust for others. This ensures that the interests of the beneficiaries are preserved, even during the financial distress of the trustee or settlor.

2.3. Role of the Companies Act, 2013

The Companies Act, 2013, further complements the protection of trust assets. Section 187, which deals with the exercise of rights and powers in respect of trust property, underscores that a company acting as a trustee must administer the trust assets in accordance with the trust deed. Additionally, Section 123 prohibits the use of trust funds for paying dividends, highlighting the need to maintain the integrity of trust assets.

2.4. Judicial Interpretation and Case Law

The Hon'ble Supreme Court's decision in *Lalit Kumar Jain vs Union of India*[3] upheld the government's notification[4] allowing creditors to initiate insolvency proceedings against personal guarantors of corporate debtors. This ruling has significant ramifications for promoters who have established family trusts to shield personal assets.

Creditors may now scrutinize transfers of assets into such trusts, especially if deemed preferential, undervalued, or fraudulent (collectively referred to as PUFE transactions). While the IBC specifies a look-back period for preferential and undervalued transactions, fraudulent transfers are subject to Section 17 of the Limitation Act, which does not impose a specific time limit.

This development underscores the importance of ensuring that asset transfers to family trusts are conducted transparently and for legitimate purposes, as any indication of intent to defraud

[3] AIRONLINE 2021 SC 402
[4] The Insolvency And Bankruptcy Code (Amendment) Act, 2019, No. 26 Of 2019

creditors could lead to legal challenges and potential unwinding of such transfers during insolvency proceedings.

In furtherance, Indian courts have consistently upheld the sanctity of trust assets in insolvency. In *State Bank of India v. Santosh Gupta*[5], the Supreme Court observed that assets held in fiduciary capacity are not subject to attachment or liquidation in insolvency. The ruling reiterated the principle that trust property is distinct from the trustee's personal or corporate assets, thereby ensuring its protection.

Another significant case, *ICICI Bank Ltd. v. Innovative Industries Ltd.*[6], provided clarity on the treatment of trust assets under IBC proceedings. The National Company Law Appellate Tribunal (NCLAT) held that the resolution professional is duty-bound to exclude trust assets from the insolvency estate, ensuring that beneficiaries' interests are not compromised.

Henceforth, The legal framework governing trust assets in India's insolvency regime ensures robust protection for beneficiaries. Provisions under the Indian Trusts Act, 1882, the IBC, and the Companies Act, 2013, collectively reinforce the principle of separating trust property from the insolvency estate of trustees or corporate debtors. Judicial precedents further solidify this legal position, ensuring that trust assets remain inviolable and dedicated to their intended purpose. This alignment of statutory provisions and judicial interpretation underscores the commitment to maintaining the sanctity of trust relationships, even amidst financial distress.

3. PRIORITY OF TRUST BENEFICIARIES VS. CREDITORS

Corporate insolvency often presents complex legal scenarios, especially when trust relationships are intertwined with creditors' claims. The conflict between the rights of trust beneficiaries and corporate creditors raises critical questions about the application of Indian trust and insolvency laws. This article examines the legal framework governing the priority of trust beneficiaries versus creditors in India, analysing relevant statutes, judicial precedents, and practical implications.

Trusts and insolvency laws serve distinct purposes in the Indian legal system. While trust laws under the Indian Trusts Act, 1882 aim to safeguard the interests of beneficiaries, insolvency laws, primarily governed by the Insolvency and Bankruptcy Code, 2016 (IBC), prioritize

[5] AIR 2017 SUPREME COURT 25 ; 2017 (2) SCC 538
[6] 2017 (11) SCALE 4

equitable distribution of a debtor's assets among creditors. When corporate entities act as trustees or hold assets in trust, disputes may arise regarding whether such assets are part of the corporate debtor's estate during insolvency proceedings. This interplay between these legal regimes and the resulting priority claims creates a nuanced and challenging legal landscape.

The Indian Trusts Act, 1882 defines a trust as an obligation annexed to the ownership of property, arising from confidence reposed in and accepted by the owner, or declared by him, for the benefit of another. Key provisions such as Section 3, which defines trust-related terms; Section 11, mandating that trustees must hold trust property exclusively for the beneficiaries; and Section 53, which prohibits trustees from using trust property to meet personal liabilities, are central to understanding the rights of beneficiaries. On the other hand, the IBC governs insolvency and bankruptcy for companies, individuals, and partnership firms. Section 18 outlines the role of an insolvency resolution professional (IRP) in managing the debtor's assets, while Section 36(4) explicitly excludes assets held in trust from the corporate debtor's liquidation estate. Furthermore, Section 53 provides the waterfall mechanism for distributing proceeds during liquidation, establishing the priority of various stakeholders.

The primary legal question revolves around whether assets held by a corporate debtor as a trustee form part of its liquidation estate. Section 36(4)(a)(iii) of the IBC affirms the exclusion of trust assets from the debtor's estate, safeguarding the beneficiaries' rights over such assets. However, proving that specific assets are held in trust requires clear documentation and adherence to trust formalities. Trustees owe fiduciary duties to beneficiaries, including the duty to segregate trust property from personal or corporate assets. Breach of this duty, such as commingling funds, complicates claims during insolvency and may expose trustees to legal liabilities.[7]

The IBC's waterfall mechanism prioritizes secured creditors, followed by unsecured creditors and other stakeholders. Trust beneficiaries' claims are not ranked under this mechanism, as trust property does not form part of the liquidation estate. However, disputes arise when creditors allege that assets purportedly held in trust were commingled or improperly documented. Judicial precedents provide valuable insights into these conflicts

[7] C. Scott Pryor ; Risham Garg "Differential Treatment Among Creditors Under Insolvency and Bankruptcy Code, 2016: Issues and Solutions" SSRN (2020)

Practical challenges in this domain include the identification of trust property, trustee mismanagement, and balancing interests. The lack of clear records often leads to disputes over whether certain assets qualify as trust property. Courts have frequently called for meticulous documentation to distinguish trust property from general corporate assets. Mismanagement, such as using trust funds for corporate purposes, undermines beneficiary's claims and complicates insolvency proceedings. Courts face the challenging task of balancing the equitable interests of beneficiaries with creditor's statutory rights under the IBC.

To address these challenges, enhanced documentation is essential. Corporations acting as trustees should maintain transparent and comprehensive records to establish the trust's existence and the identity of its assets. Judicial clarity is equally important; Indian courts should develop clearer guidelines on resolving conflicts between trust beneficiaries and creditors to reduce litigation and uncertainty. Legislative reforms to the IBC could explicitly address trust property's treatment to harmonize trust and insolvency laws effectively. Additionally, trustees and insolvency professionals should be trained on the legal nuances of handling trust property during insolvency.[8]

The priority of trust beneficiaries versus creditors highlights the complex interaction between Indian trust and insolvency laws. While existing statutes provide some guidance, practical challenges necessitate clearer judicial interpretations and legislative reforms. By ensuring robust documentation and adherence to fiduciary duties, stakeholders can mitigate conflicts and uphold the principles of equity and justice.

4. TRACING MISAPPROPRIATED TRUST ASSETS

Tracing misappropriated trust assets is a complex but essential process to ensure that beneficiaries receive what is rightfully theirs. Indian law provides a multi-faceted framework for addressing such issues, incorporating elements of trust law, corporate insolvency mechanisms, and criminal statutes[9].

The Indian Trusts Act, 1882, serves as the cornerstone for trust-related disputes in India. Under Section 23, trustees are bound to protect trust property and ensure its application in accordance

[8] Deb, S., & Dube, I. "Corporate ownership and insolvency law: An evidence from India". Common Law World Review, 53(1-2), 60-78. (2024).

[9] Atotyma Gupta "Unmasking the Asset Tracing Tools Under the Indian Insolvency Laws" National Law school business law review, volume 5 issue 1(2019)

with the trust's objectives. If a trustee misappropriates assets, beneficiaries can invoke provisions under Section 24 to compel restitution or pursue civil remedies for breach of trust.

The Companies Act, 2013, also intersects with trust law in cases where trust property has been commingled with corporate assets, particularly during insolvency proceedings. Section 66 of the Act allows for the tracing of assets transferred fraudulently or in breach of fiduciary duty, enabling creditors and beneficiaries to recover such property.

4.1. Tracing Under Insolvency Law

The Insolvency and Bankruptcy Code (IBC), 2016, provides a robust mechanism for identifying and recovering misappropriated assets during corporate insolvency. Sections 43 to 51 deal with preferential, undervalued, and fraudulent transactions. The liquidator or resolution professional can seek to reverse such transactions and trace assets back to their rightful owner.

The IBC also allows for cross-border tracing of assets, facilitated by Sections 234 and 235, which enable cooperation with foreign jurisdictions in insolvency matters. This is particularly relevant for trusts with international investments or assets held abroad.[10]

4.2. Criminal Law Remedies

In cases of trust asset misappropriation, criminal law remedies can be invoked under The Bhartiya Nyaya Sanhita, 2023 (BNS). Key provisions include:

- **Section 316**: Criminal breach of trust, applicable to trustees who dishonestly misappropriate or convert trust property.
- **Section 318**: Cheating and dishonestly inducing delivery of property, often invoked in conjunction with Section 316.
- **Section 316(5)**: Criminal breach of trust by a public servant or by a banker, merchant, or agent, imposing stricter penalties due to the fiduciary relationship.
- **Section 61(2)** - Criminal conspiracy, often misappropriation is done by multiple people henceforth attracting this proviso as well.

[10] Surbhi Pareek And Monil Chheda "Asset Tracing And Recovery: Is India Ready?" Insol International, Technical Paper Series 63 (2024)

In furtherance, The Bharatiya Nagrik Suraksha Sanhita (BNSS), supplements these provisions by providing mechanisms for seizure, attachment, and recovery of misappropriated assets.

4.3. The Role of Special Laws

The Prevention of Money Laundering Act (PMLA), 2002, is a critical tool in tracing misappropriated trust assets. Misappropriation often involves layering and integrating illicit gains to obscure their origin. Under Section 3 of the PMLA, such actions constitute money laundering, enabling authorities to attach and confiscate properties derived from the crime. The Enforcement Directorate (ED) is empowered to investigate and trace such assets.

The Benami Transactions (Prohibition) Amendment Act, 2016, also aids in tracing assets held in the names of third parties to conceal the true ownership. Under Section 2(9) of the Act, authorities can provisionally attach and confiscate benami properties, which often include trust assets misappropriated by trustees or their associates. Section 24 places the burden of proof on the alleged Benamidar, streamlining the asset recovery process.

The Companies Act, 2013, in conjunction with the Companies (Registered Valuers and Valuation) Rules, 2017, ensures transparent valuation and accounting practices, facilitating the identification of misappropriated trust assets during corporate proceedings.

The Foreign Exchange Management Act (FEMA), 1999, is also relevant in cases involving cross-border misappropriation of trust assets. FEMA regulations empower authorities to investigate and penalize unauthorized outward or inward remittances related to trust funds, aiding in the tracing of assets across jurisdictions.[11]

In *Swiss Ribbons Pvt. Ltd. v. Union of India*[12], the Supreme Court underscored the importance of identifying fraudulent transactions during insolvency proceedings. This principle is equally applicable to trust assets commingled with corporate funds.

5. CORPORATE TRUSTEES DUTIES IN INSOLVENCY

5.1. Corporate Trustees

Every person capable of holding property is eligible to be a trustee. However, when the trust

[11] Priya Misra. "Cross-border Corporate Insolvency Law in India: Dealing with Insolvency in Multinational Group Companies—Determining Jurisdiction for Group Insolvencies" Vikalpa: The Journal for Decision Makers. Volume 45, Issue 2 (2020)
[12] 2019 INSC 95

involves the exercise of discretion, the trustee must be competent to contract in order to execute it. Importantly, no one is legally bound to accept a trust. Acceptance of a trust can be indicated through any words or acts by the trustee that reasonably demonstrate such acceptance. Conversely, instead of accepting the trust, an intended trustee has the right to disclaim it within a reasonable period. This disclaimer prevents the trust property from vesting in the trustee. If there are two or more co-trustees, a disclaimer by one trustee causes the trust property to vest in the other trustee(s). This results in the remaining trustee(s) becoming the sole trustee(s) from the date the trust was created.[13]

Corporate trustees serve as distinct legal entities that manage trusts. This structure involves directors, who are the individuals running the corporate trustee. A key benefit of this arrangement is that directors enjoy limited liability protection, meaning they are not personally liable for external legal issues associated with the trust.[14] Additionally, the corporate nature of the trustee makes it easier to change directors without disrupting the operations of the trust. The trust's assets are registered in the company's name, ensuring a clear separation of personal and trust assets.

Corporate trustees are particularly advantageous for managing self-managed super funds (SMSF) and family trusts. Their longevity allows trusts to operate indefinitely, even after the death of an individual director, simplifying estate planning and succession. This is especially beneficial in reducing administrative and bureaucratic complexities often associated with other trustee structures.[15] For specific advice tailored to your circumstances, consulting a business lawyer is highly recommended.

5.2. Fiduciary and Legal Responsibilities of Corporate Trustees

Corporate trustees play a critical role during insolvency proceedings, bearing fiduciary and legal responsibilities to ensure equitable treatment of beneficiaries, creditors, and other stakeholders. A trustee is bound to execute the trust with reasonable care and diligence, ensuring that the interests of the beneficiaries are prioritized.[16]During insolvency, this duty extends to safeguarding trust assets against any potential misuse or diversion, thereby aligning

[13] The Indian Trusts Act,1882 (Act 2 of 1882), S.10.
[14] What is a Corporate Trustee?, available at: https://lawpath.com.au/blog/what-is-a-corporate-trustee (last visited on January 21, 2025)
[15] B. Hanton "International Comparative Legal Guide to: Corporate Governance". London: Global Legal Group, 4th edition (2011)
[16] Supra note 13, S.10

their actions with the objectives of the insolvency process.

Additionally, corporate trustees must comply with relevant mandates inclusive of moratorium on legal proceedings, attachments, or asset transfers once insolvency proceedings are initiated.[17] Trustees are obligated to respect the moratorium and prevent unauthorized actions that could compromise creditor claims or diminish the value of the estate. Furthermore, it is statutorily outlined in regards to the priority of payments during liquidation, imposes a duty on trustees to allocate assets fairly, ensuring that secured creditors, workmen, and other stakeholders receive payments in the statutory order of priority.[18]

The principle of good faith, enshrined in the Indian Trusts Act, 1882, also compels trustees to act impartially, balancing the interests of various stakeholders without personal bias or undue influence.[19] This is particularly critical during the resolution process, where decisions on asset distribution and restructuring require strict adherence to legal mandates and fairness principles. Breach of these duties may invite scrutiny under the Indian Trusts Act, 1882, which provides remedies for beneficiaries against trustees for acts of negligence or mismanagement.[20]

Moreover, trustees must cooperate with insolvency professionals which assigns the resolution professional the responsibility to take control of the debtor's assets and operations.[21] Trustees are expected to provide all necessary documentation, access, and support to facilitate a transparent and efficient resolution process. Failure to comply may lead to penalties under which penalizes wilful non-cooperation or concealment of information during insolvency proceedings.[22]

A contemporary example that illustrates the fiduciary and legal responsibilities of corporate trustees during insolvency proceedings is the case of Dewan Housing Finance Corporation Limited (DHFL) under the Insolvency and Bankruptcy Code, 2016 (IBC).[23] DHFL, a housing finance company, was admitted to insolvency proceedings in 2019 due to its significant debt obligations and inability to meet creditor demands. The insolvency process showcased the critical role played by trustees in safeguarding the interests of stakeholders, particularly

[17] The Insolvency And Bankruptcy Code, 2016 (No. 31 Of 2016), S. 13.
[18] The Insolvency And Bankruptcy Code, 2016 (No. 31 Of 2016), S.53.
[19] The Indian Trusts Act,1882 (Act 2 of 1882), S.11.
[20] The Indian Trusts Act,1882 (Act 2 of 1882), S.70.
[21] The Insolvency And Bankruptcy Code, 2016 (No. 31 Of 2016), S.18.
[22] The Insolvency And Bankruptcy Code, 2016 (No. 31 Of 2016), S.70.
[23] (2021) ibclaw.in 30 HC

bondholders and institutional investors.

In this case, IDBI Trusteeship Services Limited[24], the debenture trustee for DHFL's bondholders, had a fiduciary duty to protect the rights of the bondholders during the insolvency process. Acting under the Indian Trusts Act, 1882, the trustee had to ensure that trust assets, including funds collected through debenture issuance, were not mismanaged.[25] The trustee worked closely with the resolution professional (RP) to provide accurate information regarding bondholder claims and ensure their interests were represented fairly in the Committee of Creditors (CoC), as mandated.[26]

IDBI Trusteeship was responsible for ensuring that bondholders received their rightful share of the proceeds from the resolution plan approved by the CoC.[27] Given the significant exposure of retail investors in DHFL's debentures, the trustee had to balance their interests alongside those of secured creditors, such as banks and financial institutions. The resolution process led to the successful acquisition of DHFL by the Piramal Group, with bondholders receiving a portion of their claims, albeit at a haircut.

The aforementioned cases underscores the pivotal role of corporate trustees in insolvency proceedings, where they must navigate complex legal frameworks to uphold fiduciary duties, maintain transparency, and ensure fair treatment of all stakeholders. The DHFL case remains a landmark example of the interplay between trust laws and insolvency regulations, demonstrating how trustees act as key facilitators in resolving large-scale corporate insolvencies.

6. QUISTCLOSE AND CONSTRUCTIVE TRUSTS IN INSOLVENCY

6.1. Quistclose Trust and its relevancy in Insolvency

A Quistclose trust arises from a specific loan arrangement where funds are advanced by one party (the lender) to another (the borrower) with the understanding that the money will be used for a particular purpose. If the stated purpose is fulfilled, the arrangement transitions into a conventional debtor-creditor relationship, and the trust dissolves. However, if the purpose is not achieved, the lender retains a beneficial interest in the funds, effectively allowing the lender

[24] Idbi Trusteeship Services Ltd vs Hubtown Ltd; 2017 (1) SCC 568
[25] Supra note 13, S.10
[26] Supra note 21, S.18
[27] Supra note 18, S.53

to reclaim them as being held on trust. This dual-purpose nature of the arrangement provides a unique safeguard for the lender in situations where the borrower fails to use the funds as agreed.

The concept is named after the landmark case of *Barclays Bank Ltd v Quistclose Investments Ltd* [28], which established the legal foundation for this type of trust. In this case, Quistclose Investments lent money to a company specifically for the payment of dividends. When the company went into insolvency before fulfilling this purpose, the court held that the funds were not part of the company's general assets available to creditors but were held on trust for Quistclose Investments. This decision clarified that a Quistclose trust arises when the lender retains a beneficial interest in the money until it is applied for the agreed purpose.

A Quistclose trust hinges on the mutual intention of the parties that the funds are not at the free disposal of the borrower. The borrower holds the money in trust, subject to a power to use it only for the stated purpose. If this intention is absent, and the funds are provided without restrictions, no trust arises, and the funds become part of the borrower's general estate. Thus, the essential requirement for establishing a Quistclose trust is the clear agreement between the lender and borrower that the money is earmarked for a specific purpose and remains the property of the lender until applied as agreed.

In Quistclose, the funds advanced by the lender were earmarked specifically for paying dividends, and when the borrower became insolvent before fulfilling this purpose, the court held that the money was held on trust for the lender. This ensured that the funds did not become part of the borrower's general estate and were instead recoverable by the lender. A similar principle applies in India, where Section 36(4) of the IBC[29] excludes from the liquidation estate any assets held in trust for another party. This provision resonates with the Quistclose principle by affirming that trust property does not belong to the corporate debtor and cannot be distributed among its creditors.

In India, courts have acknowledged situations akin to Quistclose trusts through equitable doctrines and trust principles under the Indian Trusts Act, 1882.[30] This aligns with the Quistclose doctrine's requirement that funds must not be at the free disposal of the borrower. Indian courts have emphasized the necessity of clear evidence showing the intent to create a

[28] [1970] AC 567
[29] The Insolvency And Bankruptcy Code, 2016 (No. 31 Of 2016), S.36(4).
[30] The Indian Trusts Act,1882 (Act 2 of 1882), S.82.

trust. For instance, in *ICICI Bank Ltd v Official Liquidator of APS Star Industries Ltd.*[31], the Gujarat High Court held that money received for a specific purpose must be treated as a trust property and not part of the debtor's estate.

A Quistclose trust may also be relevant in Indian insolvency proceedings when funds are misappropriated or diverted from their intended purpose. In such cases, claimants can argue for the imposition of a resulting or constructive trust to reclaim the funds. However, the courts exercise caution in recognizing such claims to ensure they do not undermine the principle of pari passu[32] distribution under the IBC, which mandates equal treatment of creditors.

The relevance of Quistclose trusts in Indian insolvency law lies in their ability to safeguard lenders' proprietary interests while balancing the statutory framework of the IBC. By excluding trust property from the liquidation estate, Indian law provides a mechanism for honouring specific arrangements without disrupting the equitable distribution of assets. However, for a Quistclose trust to be recognized, the lender must demonstrate the clear intention to create a trust and the specific purpose for which the funds were advanced, ensuring that this doctrine is applied judiciously.

6.2. Constructive Trust and its relevancy in Insolvency

A constructive trust is an equitable remedy established by a court to address situations involving unjust enrichment, where someone wrongfully possesses property that should belong to another. The trust ensures that the wrongdoer holds the property for the rightful owner until the situation is resolved. It arises when the property is acquired unfairly, such as through fraud or a breach of fiduciary duty. The court's establishment of a constructive trust shifts ownership and benefits of the property to the actual owner, even if the property's value has changed since it was wrongfully acquired.

For instance, if an individual steals money and uses it to purchase an asset, like a car, the court may impose a constructive trust. This arrangement ensures that the asset is preserved for the rightful owner, who is entitled to its benefits. The court may then require the wrongdoer to transfer the property or repay the stolen funds. In cases where direct transfer is impractical, such as when the property has been converted into something else, the trust may be structured

[31] 2010 (10) SCC 1
[32] Pari-Passu, CFI available at: https://corporatefinanceinstitute.com/resources/commercial-lending/pari-passu/ (last visited on January 22, 2025)

to ensure the rightful owner receives its benefits.

Constructive trusts differ from resulting trusts, as the latter arise based on the parties' intentions. For example, if someone provides money for a specific purpose and the recipient uses it for themselves, a resulting trust may be imposed to reflect the original intention of the transaction. Conversely, constructive trusts address scenarios where wrongful conduct has occurred, focusing on rectifying the unjust enrichment. These trusts can be temporary or ongoing, depending on the nature of the situation and the court's directive, ensuring justice and equity are served.

Under Indian law, the Indian Trusts Act, 1882, provides a framework for trusts, including constructive trusts, through provisions such as Sections 88 and 94. Section 88 establishes that if a person in a fiduciary position gains an advantage over another, they are obligated to hold the benefits for the rightful owner.[33] Similarly, Section 94 allows courts to impose trusts as remedies in cases of wrongdoing.[34] These provisions support the principle that property held by a debtor in breach of trust or as a result of fraudulent conduct should not be treated as part of their estate during insolvency.

In the case of, *Bharat Aluminium Co. v. Kaiser Aluminium Technical Service, Inc.*[35], the Supreme Court acknowledged the importance of equity in insolvency proceedings. Although not directly addressing constructive trusts, the case highlighted the court's willingness to consider equitable principles to prevent unjust enrichment. Constructive trusts serve a similar purpose in ensuring that specific assets are returned to their rightful owners rather than being distributed among creditors.

In insolvency, constructive trusts are especially relevant in cases of fraudulent transfers, diversion of funds, or breach of fiduciary obligations. For instance, if a debtor wrongfully uses funds provided for a specific purpose, a constructive trust can ensure that the funds are returned to the rightful owner rather than being absorbed into the debtor's estate. This aligns with the overarching objective of the IBC to balance equitable treatment of creditors with the protection of legitimate claims.

[33] The Indian Trusts Act,1882 (Act 2 of 1882), S.88.
[34] The Indian Trusts Act,1882 (Act 2 of 1882), S.94.
[35] 2016 (4) SCC 126

7. CROSS BORDER TRUSTS IN INSOLVENCY

7.1. Emergence of Cross-Border Trusts

Indian trusts have emerged as a practical solution to the challenges faced by non-residents (NRs), particularly in navigating inheritance, succession, and cross-border compliance. By establishing trusts during their lifetime, Indian residents (IRs) can include Indian assets they wish their NR family members to inherit. This allows NRs to become trust beneficiaries and receive distributions directly into their non-resident ordinary (NRO) accounts, subject to applicable thresholds.[36] Current income such as interest, dividends, or rent retains its character and can be repatriated without limits, streamlining wealth transfer. Moreover, including all family members within a trust structure enables collective repatriation of significant amounts.[37] For minors, NRO accounts operated by legal guardians offer a similar mechanism.

Creating a trust circumvents the need for lengthy legal processes like probate or letters of administration. Trusts, being resident entities, overcome restrictions NRs face, such as limitations on selling immovable property. These structures can also align with tax efficiencies in both India and the NR's country of residence. For example, an irrevocable discretionary trust may suit Indian tax regulations while being configured as a grantor trust under U.S. tax laws. Families often establish separate trusts for each NR child to streamline succession planning and ensure clarity.

For those preferring to retain control over assets during their lifetime, testamentary trusts activated upon the settlor's demise are an alternative, although they still require probate. To ensure smooth succession, families increasingly engage professional trusteeship services, offering continuity and expertise in executing the settlor's wishes. These professionals also facilitate tax-efficient management of cross-border trust arrangements.

The Mumbai tax tribunal recently provided greater clarity on the tax treatment of overseas trusts.[38] A case involving an Indian resident discretionary beneficiary of a Guernsey trust affirmed the legitimacy of such structures, emphasizing that legal ownership resides with the

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[36] Cross-border trust planning: more certainty for wealthy Indian families available at: https://www.withersworldwide.com/en-gb/insight/read/cross-border-trust-planning-more-certainty-for-wealthy-indian-families (last visited on January 22, 2025)
[37] India: cross-border administration of estate available at: https://www.khaitanco.com/sites/default/files/2023-06/72-74%20SJ0623%20International.pdf (last visited on January 22, 2025)
[38] Yash Birla v. DCWT, W.T.A. No. 02 to 08/Mum/2020.

trustee.[39] This ruling reassures Indian families using overseas trusts for succession planning, asset protection, and management of investments. The tribunal's principles underscore the importance of clear documentation and non-tax motives to withstand scrutiny under India's general anti-avoidance rules, which allow authorities to disregard structures primarily designed for tax benefits.

Sophisticated cross-border structures, including private trust companies and family offices in jurisdictions like Singapore, are becoming popular.[40] Singapore, for instance, offers tax exemptions for qualifying family office setups and provides a geographically convenient, reputable base for Indian families. Changes to India's residency rules and disruptions caused by the COVID-19 pandemic have heightened the need for robust overseas arrangements. For example, Indian families managing global businesses or investments are leveraging Singapore's tax incentives and strong governance framework to enhance operational efficiency.

7.2. Role of Cross-Border Trusts in Insolvency Proceedings

Cross-border trusts play a pivotal role in insolvency proceedings, particularly in safeguarding assets and ensuring efficient resolution across multiple jurisdictions. These trusts often serve as a strategic tool for asset protection, enabling families and businesses to insulate valuable holdings from creditor claims while adhering to legal and regulatory frameworks. Their utility becomes especially pronounced in cases involving complex insolvencies, where assets are scattered across jurisdictions with differing legal principles. Recent examples highlight how such structures can either withstand or fall prey to challenges in insolvency scenarios, underlining the need for meticulous planning and robust compliance.

A notable case is the high-profile bankruptcy of Sanjeev Gupta's GFG Alliance[41]. With operations spanning multiple countries, Gupta's reliance on intricate trust structures came under scrutiny as creditors sought to recover billions of dollars. The legal proceedings revealed

[39] To Trust Or Not Trust: Mumbai ITAT affirms exclusion of corpus fund of Offshore Trust From Indian Wealth Tax available at: https://privateclient.cyrilamarchandblogs.com/2021/02/to-trust-or-not-trust-mumbai-itat-affirms-exclusion-of-corpus-fund-of-offshore-trust-from-indian-wealth-tax/ (last visited on January 22, 2025)

[40] Unlocking Cross-Border Private Markets: Tax-Efficient Structuring For Global Family Offices available at: https://www.familywealthreport.com/article.php/Unlocking-Cross_dash_Border-Private-Markets%3A-Tax_dash_Efficient-Structuring-For-Global-Family-Offices- (last visited on January 21, 2025)

[41] Steel tycoon Sanjeev Gupta's GFG alleged to have 'misappropriated' funds in Romania available at: https://www.theguardian.com/business/2022/mar/08/steel-tycoon-sanjeev-guptas-gfg-alleged-to-have-misappropriated-funds-in-romania (last visited on January 22,2025)

how cross-border trusts, when designed to preserve operational assets and creditor priorities, can shield enterprises from aggressive insolvency claims. However, allegations of mismanagement underscored the importance of ensuring transparency and a genuine economic purpose for these trusts to avoid being dismissed as mere devices for evasion.

Another contemporary example involves Chinese conglomerates, such as Evergrande, grappling with insolvency while holding international assets through trusts in jurisdictions like the Cayman Islands.[42] Courts have increasingly focused on economic substance, questioning whether these trusts genuinely serve the interests of stakeholders or operate as instruments to frustrate creditor recoveries. The recognition of offshore trusts in insolvency proceedings often hinges on how clearly, they align with the originating jurisdiction's insolvency laws and their compliance with global norms, such as those advocated by the Hague Convention on Trusts.

Indian families with overseas holdings have also turned to cross-border trusts for asset preservation amid financial distress. In one recent case, an Indian entrepreneur facing personal insolvency established an offshore trust in Singapore to safeguard family wealth.[43] Although this raised concerns about potential abuse of creditor rights, the trust withstood scrutiny due to clear documentation, legitimate estate-planning motives, and operational independence. Such examples emphasize that carefully structured trusts can endure legal challenges if their design reflects genuine objectives beyond asset shielding.

The implications of such cases extend to trustees, who must navigate their fiduciary obligations while balancing the interests of creditors and beneficiaries. Trustees of the Greensill Capital insolvency, for example, faced intense pressure as creditors sought access to trust assets.[44] The courts examined whether trustees acted within their mandates and adhered to global best practices. This case underscored the importance of trustee independence and transparency in cross-border trust governance to mitigate risks of being implicated in insolvency proceedings.

Emerging trends in global regulations further complicate the use of cross-border trusts in insolvency. The automatic exchange of financial information and heightened scrutiny under anti-money laundering frameworks compel families and businesses to ensure robust

[42] Cayman Islands restructuring of Chinese businesses: Evergrande in focus available at: https://www.bedellcristin.com/knowledge/briefings/cayman-islands-restructuring-of-chinese-businesses-evergrande-in-focus/ (last visited on January 22, 2025)
[43] CWT v. Estate of Late HMM Vikramsinhji of Gondal, TS-258-SC-2014.
[44] The Swift Collapse of a Company Built on Debt available at: https://www.nytimes.com/2021/03/28/business/greensill-capital-collapse.html (last visited on January 22, 2025)

documentation and economic substance. Jurisdictions like Singapore and the British Virgin Islands have responded by strengthening requirements for establishing and maintaining trusts, ensuring their alignment with international insolvency and governance standards.

8. CONCLUSION

The intersection of trust law and insolvency presents complex challenges and requires careful consideration of various factors to ensure the protection of both trust assets and beneficiaries' rights. The priority of trust beneficiaries over creditors is a key issue, particularly when trust assets are at risk of being misappropriated or improperly used. Tracing mechanisms play a vital role in recovering misappropriated trust assets, while corporate trustees must adhere to their fiduciary duties during insolvency proceedings to avoid breaching their obligations.

Legal doctrines such as Quistclose and constructive trusts provide frameworks for safeguarding assets even in insolvency situations, offering remedies that may allow for the separation of certain funds from the debtor's estate. Cross-border trust issues further complicate these matters, requiring an understanding of how different jurisdictions handle trust law in the context of insolvency.

Ultimately, a balanced approach that respects both the interests of trust beneficiaries and the rights of creditors is essential to uphold the integrity of trust arrangements in insolvency scenarios. The role of legal practitioners and courts is pivotal in navigating these issues, ensuring that trust assets are preserved, and the duties of trustees are diligently fulfilled.