

RECENT DEVELOPMENTS IN TAXATION OF CHARITABLE TRUSTS

RECENTS AMENDMENTS:-

SECTION 11

The following sub-sections (6) and (7) shall be inserted after sub-section (5) of the section 11 by the Finance (No. 2) Act, 2014, w.e.f. 1-4-2015:

(6) in this section where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year.

(7) Where a trust or an institution has been granted registration under clause(b)of sub-section (1) of section 12AA or has obtained registration at any time under section 12A[as it stood before its amendment by the Finance (No. 2) Act, 1996 (33 of 1996)] and the said registration is in force for any previous year, then nothing contained in section 10 [other than clause (1) and clause (23C) thereof] shall operate to exclude any income derived from the property held under trust from the total income of the person in receipt thereof for that previous year.

PROVISO TO SECTION 12A(2)—(INSERTED BY THE FINANCE NO.2, 2014 W.e.f. 01/10/2014)

- **Provided** that where registration has been granted to the trust or institution under S. 12AA, then, the provisions of sections 11 and 12 shall apply in respect of any income derived from property held under trust of any assessment year preceding the aforesaid assessment year, for which assessment proceedings are pending before the Assessing Officer as on the date of such registration and the objects and activities of such trust or institution remain the same for such preceding assessment year.
- **Provided further** that no action under section 147 shall be taken by assessing officer in case of such trust or institution for any assessment year preceding the aforesaid assessment year only for non- registration of such trust or institution for the said assessment year.
- **Provided also** that provisions contained in the first and second proviso shall not apply in case of any trust or institution which was refused registration or the registration granted to it was cancelled at any time under section 12AA.

SECTION 12AA(4)—(INSERTED BY THE FINANCE NO.2, 2014 W.e.f. 01/10/2014)

- Without prejudice to the provisions of sub- section (3), where a trust or an institution has been granted registration under clause(b) of sub-section (1) or has obtained registration at any time under section 12A [as it stood before its amendment by the finance (no. 2) Act, 1996 (33of 1996)] and subsequently it is noticed that the activities of the trust or the institution are being carried out in a manner that the provisions of section 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of sub- section (1) of section 13, then, the principal commissioner or the Commissioner may by an order in writing cancel the registration of such trust or institution.
- **Provided** that the registration shall not be cancelled under this sub-section, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner.

RECENT CBDT NOTIFICATIONS:

1. CBDT notifies limit of 50% Govt. Grant for deeming educational institute/university/hospitals as substantially financed by Govt. (Noti. No. 79/2014/ F.NO. 142/12/2014-TPL)
2. CBDT has authorised the CIT(Exemptions) to act as 'prescribed authority' for the purposes of grant of approvals u/s. 10(23C)(iv,v,vi,via) ((Noti. No. 75 & 76/2014/ Dated 1.12.2014

REGISTRATION STAGE

- **PROVISO TO SECTION 2(15) (Inserted by Finance (No. 2) Act, 2009 w.e.f. 1.4.2009)**
- **1. Registration cannot be cancelled as exemption is to be given year on year basis.**
- 1.(i). Trust can be denied exemption in the year where the gross receipts exceed the limit prescribed in the second Proviso to Section 2(15); and in all other year proviso will not be applicable.
- 1.(ii). This Fact alone will not make the trust non-genuine. Exemption will be denied; registration need not be cancelled. **(Vanita Samaj 1034/Mum/2012, Dt. 26/02/2014) (2009-10)**
- **2. Though business – but still Charitable- in spite of proviso added- Basic Principle remains the same:** “Hon’ble Apex Court in the earlier case of Andhra Chamber of Commerce had clearly laid out the principle that if the primary purpose of an institution was advancement of objects of general public utility, it would remain charitable in nature even if an incidental or ancillary activity or purpose, was profitable in nature. The basic principle underlying the definition of “charitable purpose” remained unaltered even on amendment in the section 2(15) of the Act w.e.f. 01/04/2009, through the restrictive first proviso was inserted therein- **(Kolkata tribunal – Indian chamber of commerce vs. ITO, (2014) 52 TAXMAN com. 52, Kolkata Tribunal)**.

3. COMMENCEMENT OF ACTIVITY- PRE CONDITION ???

- 3.(i). Commencement of activity is not a condition precedent for grant of Registration under Section 12AA. **(DIT(E) vs. Seevri Samaj Tambar am Trust)(43 TAXMAN.com, 142 MADRAS).**
- 3.(ii) No section 12A registration to trust when it hadn't incurred anything for achieving its charitable objects. IT: where company had not incurred even a single penny to achieve its objectives, i.e. charitable purposes, it was not eligible to grant for registration under section 12A. **(Indian Tools Technology Centre vs. CIT-I, Jalandhar. [2014] 42 Taxman.com 359 {Amritsar Tribunal.}).**
- **3. New Trusts- No waiting Period:-** Registration under section 12A – carrying on of charitable activities- statute does not prohibit or enjoin the CIT registering trust solely based on its objects, without any activity, in the case of a newly registered trust- Statute does not prescribe a waiting period, for a trust to qualify itself for registration- Tribunal was therefore right in holding that while examining the application under section 12AA(i)(b) r/w section 12A, the CIT/ director is not required to examine the question whether the trust has actually commenced and has, in fact, carried on charitable activities. **(DIT vs. Foundation of Ophthalmic & Optometry Research Education Centre(2012) Delhi High Court, 254 CTR (Delhi),133)**

PROVISO TO SECTION 2(15)- EXEMPTION STAGE

- **1. Exemption stage –To see:**
- 1.(i). Object;
 - 1.(i).(a). Charitable
 - 1.(i).(b). General public utility
- 1.(ii). Surplus Generated was incidental or secondary
- 1.(iii). While defining the term business for the purpose of Section 2(15) which defines the term charitable purpose , the object of main section 2(15) has to be kept in mind.
- 1.(iii).(a). Not intended to include very broad and extended definition of 'Business' so as to include any transaction for fee or money.
- **2. CHARGING FEE IS VULNERABLE---???**
- 2.(i). In DIT(E) vs. Sabarmati Ashram Gaushala Trust Tax appeal 1162/2013, Dt. 15/01/2014.Gujarat high court held as under;
- 2.(i).(a) Relied on FM speech in the parliament:-

FM SPEECH: "I once again assure the house that genuine charitable organizations will not in any way be affected. The CBDT will, following the usual practice, issue an explanatory circular containing guidelines for determining whether any entity is carrying on any activity in the nature of trade, commerce or business or any activity of rendering any service in relation to any trade, commerce or business. Whether the purpose is a charitable purpose will depend on the totality of the facts of the case. Ordinarily, chambers of commerce and similar organizations rendering services to their members would not be affected by the amendment and their activities would continue to be regarded as "advancement of any other object of general public utility"

- **CBDT CIRCULAR:**

- **2.(i)(b).** CBDT Cir 11/2008, Dt. 19/12/2008:- "the newly inserted proviso to section 2 (15) will apply only to entities whose purpose is 'advancement of any other object of general public utility' i.e. , the fourth limb of the definition of 'charitable purpose' contained to section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial Activities. Whether such an entity is carrying on any activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of activity.
- There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as they are covered under 'any other object of general public utility' under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants. Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organization and there activities are restricted to contributors from and participation of only their members, these would not fall under the preview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealing with non-members, their claim to be chargeable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

CONTD....

- In the final analysis, however, whether the assessee has for its object ' the advancement of any other object of the general public utility' is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, **the object of ' general public utility' will be only a mask or a device to hide the true purpose which is trade, commerce or business** or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible. Assessee, who claim that their object is 'charitable purpose' within the meaning of section 2(15), would be well advised to eschew in any activity in the nature of trade, commerce or business, or the rendering of any service in relation to any trade, commerce or business.
- **2.(i)(c).** Trust was carrying on its activities on non-commercial basis & with no motive to earn profit.
- **2.(i)(d).** Incidental profit as while implementing objects which are charitable.
- **3. Business Defined:** Hon'ble Supreme Court of India in the case of CIT vs. Sai Publication Fund (2002) 177 CTR (SC) 1 : (2002) 258 ITR 70(SC) : (2002) 122 Taxman 437 (SC) in which the Supreme Court interpreting the word "business" under s. 2(5A) of the Bombay Sale-tax Act, 1959 had clearly laid out that where main activity is not 'business' the connected incidental or ancillary activities of sales carried out in furtherance of and to accomplish their main objects would not, normally, amount to business, unless an independent intention to conduct 'business' in these connected, incidental or ancillary activities is established by the revenue.

- **4. Predominant object** of the assessee-association viz. promotion development and protection of trade and trade and commerce which is an object of general public utility, and the activities of conducting environment management centre, meetings, seminars and issuance of certificate of origin to exporters being incidental and ancillary to the main purpose, it cannot be said that the assessee is predominately engaged in business and, therefore, exemption under s.11 cannot be denied to assessee, assessee primary purpose being a charitable purpose, assessee I not hit by a proviso to s. 2(15) even though the incidental and ancillary activities carried on by it are profitable in nature. (**Indian chamber of commerce vs income tax officer ITAT, Kolkata 'c' bench (2015) 113 dtr (Kolkata tribunal) 153**).
- **5. ICAI vs. DGIT (exemption) 347 ITR99 (Delhi)- DELHI, HIGH COURT**
 - 5.(i) Fundamental or Dominant function was seen.
 - 5.(ii). Merely because the ICAI is holding coaching classes and generated surplus; proviso to section 2(15) is not applicable.
- **6. Cow Breeding- Sale of Milk:-** where assessee-trust was established for purpose of cow breeding and protection of cows and oxen, incidental income earned by it from sale of milk could not be regarded as carrying on activity of trade or commerce with in meaning of proviso to section 2(15). (**Shree Nashik Panchvati Panjarpole V. DIT(E) (2014) 45 taxman.com 220, Mumbai-trib.**)

CANCELLATION OF REGISTRATION-NO :

- **1.** PROVISO TO SECTION 2(15)- If Receipt >10 LAC/25LAC, registration is not affected, but loses exemption.**(Ghatkopar Jolly Gymkhana vs. DIT 37CCH203 MUMBAI TRIBUNAL)**
- **2.** Registration can be cancelled if;
- **2.(i).** In the absence of any evidence on record to establish that the activities carried on by the assessee-trust were not genuine or that it is not carrying on its activities in accordance with its objects, registration granted to the assessee could not be cancelled by the invoking section 12AA(3) on the ground that supplementary trust deed has been executed without obtaining prior approval, when the supplementary trust deed is nothing but the combination of all the clauses of the earlier two trust deeds and the aims and objects in all the deeds remains the same. **(Satkrit Service Trust vs. CIT 92 DTR(CHD. TRIB.)178)**
- **3.** Object are to be seen only with reference to the Act that prevailed as on date of registration.
- **3.(i).** Even if Exemption not given due to commercial nature; registration cannot be cancelled.**(Tamilnadu Cricket association Vs. DIT 86CCH212 (Chennai H.C.)**

15% OF WHAT MEANING OF INCOME--??

- Income Means What: Gross Receipts or Net Income:
Different Stages of Receipts / Income:

GROSS RECEIPT ->-> EXPENSES INCURRED ->-> INCOME

INCOME ->-> APPLICATION (CAPITAL OR REVENUE) ->-> SURPLUS

SURPLUS (ACCUMULATION TO BE MAX. 15%)

- **Gross Receipts:** Circular No. 5 of 1968 issued by the central Board of Direct Taxes, in Paragraph 2 of the said circular, the board has clarified that concept of income in s. 11 is different from the 'total income' in s. 2(45).
- **ACCUMULATION**
- 1. The 15% accumulation is to be computed with reference to the commercial income of the Trust before considering the amount applied by the Trust on its objects. In CIT v. Programmed for Community Organisation 248 ITR 1 (SC), the trust had received donations of Rs. 257376/- and it applied for its charitable purposes the aggregate sum of Rs. 170369. leaving a balance of Rs. 87010. The Supreme Court held, that on the plain language of Section 11(1)(a), the assessee was entitled to accumulate 25% of Rs. 257376 and not merely 25% of the balance of Rs. 87010/-
- 2. It is the income computed on commercial principles which is available for accumulation u/s 11(1)(a) the contention that in case of trust, gross receipts is the income of trust, in the light of above decisions we find is not well founded. Accordingly, the income available for accumulation u/s 11(1)(a) is the income as computed on the commercial principles, as also taking into account the provisions of IT act 1961. However, the contention on the behalf of the assessee, that the entire non code expenditure can not be attributed to the earning of the income of the assessee is acceptable. The contention of the assessee that most of the expenditure has been incurred in connection with the application of income and not in connection with earning of income. So only the expenditure incurred for earning the income alone would be deductible in computing the income of the trust for purposes of accumulation. ITO v. GEM Jewellery Export Promotion council (1999) 68 ITD 95 (BOM).

- **3. Administrative Expenses:** Administrative expenses should not be deducted from the gross income to compute income for the purpose of Section 11, unless they are directly attributable to the earning of such income. Such
- A view is being taken by tax authorities that administrative expenses of a Trust should be deducted to compute the income of a Trust for the purpose of Section 11. Treatment of such expenses as a deduction while computing income, instead of treatment of such expenditure as an application of income for charitable or religious purposes, results in reduction of the permissible accumulation under Section 11(1)(a). While it is no doubt true that the concept of commercial income requires deduction of expenses directly incurred to earn the income (such as fund-raising expenses, expenses for soliciting donations, interest collection charges, etc.), it cannot be said that all the administrative expenses are incurred only to earn income. Administrative expenses may also be incurred for the general objects and activities of the Trust. Hence, administrative expenses should not be deducted from the gross income to compute income for the purpose of section 11, unless they are directly attributable to the earning of such income. Such expenses are however deductible under the provisions of Section 11(1)(a), as an application of income for charitable or religious purposes.

- This view is supported by the decision of the Madhya Pradesh High Court in the case of Parsi Zoroastrian Anjuman Trust, Mhow v. CIT (1987) 163 ITR 832. A similar view has also been taken by the Calcutta High Court in the case of CIT v. Birla Janahit Trust (1994) 208 ITR 372, where the Court held that the expenditure on salaries and miscellaneous expenses for the purpose of carrying out the objects and purposes of the Trust must be considered as application for charitable purposes. Similarly, in the case of Gem & Jewellery Export Promotion Council v. ITO, 68 ITD 95 (Bom), the Tribunal has held that entire non-code expenses could not be attributed to the earning of income, and only expenditure incurred for earning the income is to be reduced from the gross income for computing the income on which accumulation under s. 11(1)(a) is to allowed.
- The Supreme Court in CIT v. Programme for Community Organisation, 248 ITR 1, held that having regard to the plain language of Section 11(1)(a), it is clear that a charitable or religious Trust is entitled to accumulate 25% of its income derived from property held under Trust. The income for such purpose is to be computed on commercial basis. The Supreme Court held that outgoings which are in the nature of application of income cannot be excluded in computing the income of the Trust for the purpose of determining the permitted 25% (now 15%) accumulation. This view has also been followed by the

Bombay Tribunal in the case of Bai Sonabai Hirji Agiary Trust, 272 ITR (AT) 67 and in Prince of Wales Museum Of Western India, 86 TTJ 285.

- In **PRINCE OF WALES MUSEUM OF WESTERN INDIA vs. INCOME TAX OFFICER** (2004) 86 TTJ (Mumbai) 285:-
- Apropos Ground No. 2, we have observed that the CIT(A) computed the sum of (illegible) as referred to under s. 11(1)(a) of the IT Act, 1961 (hereinafter called the Act) as under :
- **GROSS RECEIPTS :-**

Income	1,16,64,000
Admission fees	33,86,319
Interest	16,27,552
Other Income	29,44,891
	1,96,22,762
Less : Administration expenses	3,96,921
	1,92,25,841
Less : Establishment expenses	64,43,319
	1,27,82,522
Less : 25% under s. 11(1)(a)	31,95,631
Less : Already allowed by the AO	25,18,829
Relief	6,76,802

5. The controversy crept in this appeal hinges around the computation of the income accumulated or set apart as contemplated under s. 11(1)(a). Assessee claims that such amount should be 25 per cent of Rs. 1,96,22,762, i.e., Rs. 49,05,690. CIT(A) computed this sum at Rs. 31,95,931 after deducting the administration and establishment expenses from the gross receipts.

CIT(A)'S VIEW WAS CONFIRMED on the basis that administrative and establishment expenses can be said to have been incurred for maintenance of office and museum for day to day expenditure and to keep the museum in good shape.

In. **BAI SONABAI HIRJI AGIARY TRUST (2004) 85 TTJ (MUMBAI)(SB)907:**

GROSS RECEIPTS		352962.00
LESS:- ADMINISTRATIVE EXPENSES	47984	
DEPRECIATION	<u>24646</u>	
		<u>72630.00</u>
		280332.00
25% of 280332 (To be accumulated)		70083.00

In (COMMISSIONER OF INCOME TAX vs. MANAV MANGAL SOCIETY (2011) 237 CTR (P&H) 519) the facts were as under:-

The assessee is running a school and claimed exemption under s. 11 of the Act in respect of its income. The AO rejected the claim on the ground that the assessee had not applied 85 per cent of the profits for the purpose of the society, as required under s. 11 (4A) r/w s. 11(2) of the Act. This view was reversed by the CIT(A) taking into account the fact that the assessee had spent the amount equal to more than 85 per cent. The relevant observations are as under :

“The details of income of the society and schools as per P&L a/c attached with the return are as under:”

		Before application of income to charitable purposes (in Rs.)	After application of income to charitable purposes (in Rs.)
(a)	Manav Mangal Society	2,67,832	74,905
	Manav Mangal School, Chandigarh	1,05,54,039	4,58,708
	Manav Mangal School, Panchkula	1,53,32,255	30,31,368
		2,61,54,126	35,64,981

As per judgment of the Hon'ble Court, the assessee society has applied an amount of (Rs. 2,61,54,126 minus Rs. 35,64,981) Rs. 2,25,89,145, which works out to 86.36 per cent leaving a balance of Rs. 13.64 per cent (Rs. 35,64,981) for accumulation. According to the Authorised Representative, the learned AO has wrongly applied the percentage of 85 to the unspent balance as against to the figure of Rs. 2,61,54,126. It was claimed that since the assessee society has spent/applied its income to charitable purpose more than the statutory requirement, it is not liable to income-tax for the year under consideration. He contended that as the action of the learned AO in taxing the assessee is not within the legal framework, it was urged that the same may be quashed and impugned addition be deleted."

The assessee's contention was accepted by CIT(A) and ITAT. Before The Hon'ble High Court, though the question raised was whether to consider the investment in building as application or not. But the above facts have been narrated in the judgment, so are relevant for the purpose of our discussion.

4. NEAR TO IMPOSSIBLE: If the figure of net profit is to be considered to calculate 15%, it will lead to do something impossible. Because, to apply net profit upto the extent of 85% may not be possible in almost all cases.

5. CONCLUSION:

1. It is neither the gross receipts nor the net profit which is to be considered for the purpose of arriving at the figure of 15% to be accumulated.
2. It is the amount of income arrived at after deducting from the gross receipts the expenses incurred to earn the receipts.

LOAN REPAYMENT

1. Repayment of Loan is application even though not treated as income during the year of taking of loan. **(Shri Ram Scientific and Industrial Research Foundation vs. JDIT 33 CCH 162), (Del. Trib.)**
2. Repayment of Loan is application. **(DIT(E) vs. Govinda Naicker Estate (2009) 315 ITR 237 (MADRAS)**
3. Receipt Back of Loan is not Income as Return of loan by a debtor to a creditor can never constitute income. **(CIT vs. Trustee of Kasturbai scindia Commission Trust (1991) 189 ITR 5 (BOM),).**
4. It is primarily on the basis of CBDT circular No.100 DT. 24/01/73

GENERAL

1. Exemption denied:

1.(i). Exemption denied to a trust as construction of commercial building wasn't in its object clause;

1.(i).(a). In order to get the benefit under section 11, the condition as mentioned in section 12A have to be fulfilled, meaning, thereby, the trust has to get the registration as required. Section 12AA provides for procedure for registration. Granting registration does not ipso facto entitle the assessee to get the benefit under section 11. The registration initially recognizes the charitable activities of the trust. However, in order to get the benefit under section 11, factually it has to be established that income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes. If the factual aspect is not established, the registration does not help otherwise.

1.(i).(b). All the authorities below have found that the application of the fund is not made for charitable activity, but the construction of the building, which again does not directly reflect for charitable activities. Even on the record, it does not appear that the assessee had intended to apply the future income, which might be derived from the building so constructed.

1.(i).(c). Therefore the appeal filed by the assessee was liable to be dismissed. **(Kamma Sangham vs. DIT(E), Hyderabad. [2014] 43 Taxman.com 192 {Andhra Pradesh})**.

2. Amendment in Trust Deed is ok if authorized by deed itself.

3. Corpus: For specific directions; Provision section 11(1)(d) does not say that the purpose for which such donation is given should be specified. It is sufficient if donation is specific for corpus fund. **(Chennai IT A/Y 2012/13, 1796/Mds/2012-2009/10 in Bhaktavatsalam Memorial Trust).**

CAPITAL RECEIPT: . IT : Where society, running school, had received development fund as part of students fee which was utilised in amenities and welfare of students, same was to be regarded as capital receipt not chargeable to tax. [2014] 49 taxmann.com 294 (Delhi Trib.) Income-tax Officer (Exemption) v. J.D.Tytler School Society)

4. Notice of 11(2) not filed in prescribed format-allowed:

4.(i). Exemption under section 11(2) cannot be denied to assessee on mere technical grounds when information with full details as required under form no. 10 was furnished for setting apart and carrying forward the unspent amount for spending in next year by the assessee.

4.(ii) the insistence of furnishing of information under form 10 as a condition precedent, is insistence on the form and not the substance of the provisions of the Act. **(CIT vs.. Moti Ram Gopi Chand Charitable Trust, 30/12/2013, ITA 349/2013 Allahabad High Court ,(2013) 87 CCH 013. Allahabad High court).**

5. Registration under section 12A is a condition precedent to claim exemption under section 11 & 12. **(U.P. Forest Corporation vs. DCIT (2008) 297ITRI (SC).**

6. Blood relatives allowed: No provision in Society Registration Act or in IT Act to Bar Relatives. **(New Delhi 4182/Del/2013 A/Y 2009/10 Institute of Marketing & Management).**

7. Jurisdiction of ITAT is determined on the basis of location of A.O. who passed the order in appeal.

8. DEPRECIATION: If two types of Assets:-

(i). Assets which have been considered as application- NO depreciation is admissible.

(ii). Assets which have not been so considered as application-

- Depreciation to be allowed.

- RATE OF DEPRECIATION NEED NOT BE AS PER SECTION 32.

9. S. 50C APPLICABLE?? : Whether the deeming fiction created by virtue of section 50C in determining capital

gain can be extended to section 11(1A)- held No

Gyanchand Batra vs. Income Tax Officer 115 DTR 45 (JP-Trib);

ACIT-1 Vs. Shri Dwarikadhish Temple Trust (ITA Nos.256 & 257/LKW/2011

Lukhnow Bench-B)

Asstt. CIT Vs. M/s The Upper India Chamber of Commerce, ITA No.

601/LKW/2011, Dt. 05.11.2014,

ITAT - Lucknow) ;

10. PENALTY: Penalty for late filing of return of income Rs. 100 per day (Section 272(2)(e)).

11. IF TRUST NOT REGISTERED UNDER SECTION 12A:

(i). Requirement of Audit under section 12A- NO

(ii). Normal income to be taxed.

(iii). Rate of tax as per section 164(2).

(iv). Earlier year income should comply with provisions of section 11 & 12.

12. FOLLOWING ARE VULNERABLE:

(i). Higher rate of profit margin. (ii). Other objects in objects clause.

(iii). Charging of Fee

FORFEITURE OF EXEMPTION & RATE OF TAX

1. If exemption under section 11 & 12 denied, normal provisions of the Act to apply: income should be computed as per the normal provisions of the Act. Meaning thereby it is not the gross receipt to be subject to tax but only the net taxable income to be taxed.

2. Only surplus or profit can be brought to tax of the same has to be computed in the manner laid down in the Act applying normal principles of accountancy and taxation. **(Hyd. B. Bench : 90ITD 493 (Hyd.) Society for integrated development in urban & rural Areas vs. DCIT.)**

3. It is net income not gross income which is chargeable to tax. **(DIT(E) vs. Pariwar Sewa Sanstha), (2007) 110TTJ DEL. 861.**

4. where assessee trust was held not entitled to exemption under section 11 & 12, income of assessee to be computed under general provisions of Income Tax Act Viz. IfoS, CC etc. **(Ajay G. Pirmal Foundation vs. ADIT 48 TAXMAN.com 30 DELHI TRIB.)**

(A) TOTAL FORFEIT OF EXEMPTION: Where a Trust has not utilized any income at all nor applied for accumulation, or has totally forfeited exemption under Section 11, the income liable to tax will be its total income as computed under the Act, and not its actual income. However, the Trust will be entitled to all the reliefs available to an assessee; e.g., relief under Section 80-G, exclusion of totally excluded income, etc.

(B) RATE OF TAX :

RATE OF TAX ON CHARITABLE OR RELIGIOUS TRUSTS:

1. SECTION 164(2) READ WITH ITS PROVISIO READ AS :

"164(2) In the case of relevant income which is derived from property held under trust wholly for charitable or religious purposes, or which is of the nature referred to in sub-cl. (iia) of cl. (24) of s. 2, or which is of the nature referred to in sub-s. (4A) of s. 11, tax shall be charged on so much of the relevant income as is not exempt under s. 11 or s. 12, as if the relevant income not so exempt were the income of an AOP :

Provided that in a case where the whole or any part of the relevant income is not exempt under s. 11 or s. 12 by virtue of the provisions contained in cl. (c) **(PAYMENT TO SPECIFIED PERSONS)** or cl. (d) **(INVESTMENT VIOLATIONS)** of sub-s. (1) of s. 13, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate."

2. IN INCOME TAX OFFICER VS. SHRI HANUMAN MANDIR TRUST (2003) 78 TTJ (PUNE) 469 : (2003) 84 ITD 83 (PUNE)

- The assessee-trust filed a return of income declaring total income of Rs. 21,737 on 31st May, 1995. Since the return was filed beyond the time-limit under s. 139, the said return was regularised under s. 148. In the return of income, the status of the assessee was shown as that of AOP (Trust).
- During the course of scrutiny, the AO observed that the assessee had claimed deduction of Rs. 7,000 under s. 80L of the Act in respect of income from interest from bank. The AO observed that the said deduction is not allowable. He further observed that the assessee had incurred expenditure on the objects of the trust much below 75 per cent of the total income. He further stated that though Form 10A for registration under s. 12A was filed on 22nd Feb., 1994, no registration under s. 12A was obtained and, therefore, benefit of ss. 11 to 13 were not admissible. On this ground, he computed the income of the trust at Rs. 24,940 and also computed the tax on the said income at maximum marginal rate and denied deduction under s. 80L of the Act.
- Conclusion: i. Assessee-trust established for propagation of Hindu Vaidic religion and to build and maintain temples being a public charitable trust, was assessable under s. 164(2) in the status of AOP at minimum marginal rate; there being no failure on the part of assessee under s. 13(1)(c) or s. 13(1)(d), proviso to s. 164(2) would not apply.
- ii. Assessee, a public religious trust assessed under s. 164(2) as an individual was eligible for deduction under s. 80L.

**3. IN DIRECTOR OF INCOME TAX (EXEMPTIONS) VS. SHETH
MAFATLAL GAGALBHAI FOUNDATION TRUST THE HON'BLE HIGH
COURT OF BOMBAY HELD AS UNDER:- (2001) 168 CTR (BOM) 501 :
(2001) 249 ITR 533 (BOM):**

- Liability in special cases—assessment of trust—maximum marginal rate under s. 164(2), proviso—as per proviso to s. 164(2) where whole or any part of relevant income of the trust is not exempt under s. 11 or s. 12 because of contravention of s. 13(1)(d), tax is chargeable on such income or part thereof at the maximum marginal rate—only the non-exempt portion of income would fall in the net of tax as if it was the income of an aop—said proviso categorically refers only to that part of income which has forfeited exemption and not the entire income—this is also clarified by circular no. 387, dt. 6th july, 1984—assessee-trust was required to dispose of the shares held by it in a company by 31st march, 1993, in view of s. 13(1)(d)(iii)—same not done—maximum marginal rate will apply only to dividend income and not to entire income.

HELD

Sec. 164(2) refers to the relevant income which is derived from property held under trust wholly for charitable or religious purposes. If such income consists of severable portions, exempt as well as taxable, the portion which is exempt is to be left out and the portion which is not exempt is charged to tax as if it is the income of an AOP. Therefore, a proviso was inserted by the Finance Act, 1984 w.e.f. 1st April, 1985, under which in cases where the whole or any part of the relevant income is not exempt under s. 11 or s. 12 because of the contravention of s. 13(1)(d), the tax shall be charged on such income or part thereof, as the case may be, at the maximum marginal rate. In other words, only the non-exempt income portion would fall in the net of tax as if it was the income of an AOP. The phrase 'relevant income or part of the relevant income' in the proviso is required to be read in contradistinction to the phrase 'whole income' under s. 161(1A). This is only by way of comparison. Under s. 161(1A), which begins with a non obstante clause, it is provided that where any income in respect of which a person is liable as a representative assessee consists of profits of business, the tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate. Therefore, reading the above two phrases shows that the legislature has clearly indicated its mind in the proviso to s. 164(2) when it categorically refers to forfeiture of exemption for breach of s. 13(1)(d), resulting in levy of maximum marginal rate of tax only to that part of the income which has forfeited exemption. It does not refer to the entire income being subjected to maximum marginal rate of tax. This interpretation is also supported by Circular No. 387, dt. 6th July, 1984. Vide the said Circular, it has been laid down in para 28.6 that where a trust contravenes s. 13(1)(d), the maximum marginal rate of income-tax will apply only to that part of the income which has forfeited exemption under the said provision and not to the entire income. There is a vital difference between eligibility for exemption and withdrawal of exemption/forfeiture of exemption for contravention of the provisions of law. These two concepts are different. They have different consequences. In the circumstances, there is merit in the contention of the assessee that in the present case the maximum marginal rate of tax will apply only to the dividend income from shares held in contravention of s. 13(1)(a) and not to the entire income. Therefore, income other than dividend income shall be taxed at normal rate of taxation under the Act. (Para 6).

CONCLUSION

In case of contravention of s. 13(1)(d), maximum marginal rate of tax under s. 164(2), proviso is applicable only to that part of income of the trust which has forfeited exemption and not to the entire income.

RATE OF TAX SECTION 164 (2) & (3)

1. Income which is not exempt under section 11& 12 – shall be charged at the slab rate, the basic exemption (160000) will be available.

2. **PROVISO TO SECTION 164(2):** If income is not exempt due to operation of section 13(1)(c) (**PAYMENTS TO SPECIFIED PERSONS**), section 13(1)(d) (**INVESTMENT VIOLATIONS**) rate of tax will be maximum marginal rate of tax.

RATE OF TAX:

The rate of tax applicable to a Public Trust for the purpose of assessment under the Income Tax Act is that applicable to an 'Association of Persons'. If the Trust is not exempt under Section 11, it will have to pay tax as per the provisions of sub-Section (2) and (3) of Section 164 of The Income Tax Act.

NORMAL SLAB RATE: Section 164(2) and (3) provide that the portion of Income derived from property held under Trust either wholly or partly for charitable or religious purposes; voluntary contributions received as contemplated under Section 2(24)(iia), or business income as contemplated under Section 11(4A).to the extent not exempt under Sections 11 or 12, shall be charged to tax, at the appropriate rate to the income of an association of persons. Consequently, the basic exemption (currently Rs. 2,00,000) would also be available.

MAXIMUM MARGINAL RATE: The provisos to Sections 164(2) and (3) further provide that the portion of income not exempt under Section 11 or 12 by virtue of the fact that:

- a. any part of income has been used or applied directly or indirectly for the benefit of any of the excluded persons as contemplated under Section 13(1)(c) read with Section 13(3); or
- b. any funds of the trust have not been invested or deposited for any part of the year in consonance with provisions of Section 13(1)(d) read with Section 11(5);

shall be charged to tax at the maximum marginal rate of tax as defined by explanation 2 to Section 164

- **BENEFITS AS INDIVIDUAL:** Though the rate of tax applicable to a public charitable or religious Trust would be that applicable to an “Association of Persons”, the status of the Trust for the purpose of taxation would be “individual”, as held by the Bombay High Court in the case of DIT(E) v.Shardaben Bhagubhai Mafatlal Public Charitable Trust, (2001) 247 ITR 1. The Trust will therefore be entitled to the benefit of deduction under section 80L till assessment year 2005-06. The trustees are representative assesses, who are liable to tax under Section 161(1) in the like manner and to the same extent as the beneficiaries. Section 164 merely prescribes the rate of tax applicable. The trustees do not derive their authority from the beneficiaries, but from the settler. They have not come together for a common purpose to earn income, but are merely recipients of the income derived by the Trust. They cannot be therefore considered as an association of persons or a body of individuals.
- The Bombay high Court basically followed the decision of the Madras High Court in the case of CIT v. Marsons Beneficiary Trust, 188 ITR 224, where it was held that the term individual does not mean only a human being but it includes a group of persons forming a unit. The court rejected the argument of the tax authorities that the trustees were acted on behalf of the beneficiaries and that the beneficiaries constituted an association of persons. As such, it was held that the status of a public charitable or religious Trust would be that of an ‘individual’. Also refer CIT v. Shree Krishna Bandar Trust, 201 ITR 989 (Cal).

CHARITABLE INSTITUTIONS CHECK LIST

- i) Applied 85% of the Income - Yes/No.
- ii) (a) If No; to file option as per exp. 2 to s. 11(1) or as per s. 11(2) before due date of filing of ROI as per s. 139(1).
- ii) (b) If option exercised –To apply income within the time allowed.
- iii) To keep funds as per s. 11(5) mode.
- iv) Payment to specified persons be kept under check/not excessive.
- v) To continue doing activities so as to achieve objects of the Trust.
- vi) To keep surplus under check.
- vii) Audit as per s. 12(1) (b).
- viii) Charging of fee – should not lead to doing business.
- ix) After coming into existence; to commence activities by Trust
- x) In case of Corpus donations – to take written directions of donor.

THANKING YOU

SUBHASH JAIN

M. Com. (Gold Medalist)

F.C.A., I.C.W.A., DISA (ICAI)