Proposals relating to Public Charitable Trusts & Institutions

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The year 2020 was marred and disfigured by the widespread effect of COVID19 pandemic world over which literally strangulated the growth of majority of the promising economies including India. The government virtually followed the holistic and pragmatic approach and accordingly infused economic stimulus by introducing one of the largest economic packages popularly called the 'Atamnirbhar Bharat' with the intent to raise the criterion from being a sluggish economy to a vibrant one. The Budget (for short "Bill") was so expected to introduce a line of incentives to boost the myriad sectors of the economy as a whole and to achieve the so called projected growth rate for the year 2021. It is being termed as a "Budget of Hope" and indeed the Government left no stone unturned to provide the desired push to the ailing economy. The focus was to boost the 'Make in India' initiative, infrastructure sector and make India a financial services hub to attract foreign investments.

2. Taxation of charitable trusts & institutions (hereinafter referred to as "Trust" for short) has been under scanner in recent times and Government in last few years have brought in various amendments in the relevant provisions governing the taxation of charitable This article proposes to deal with the proposals relating to taxation of public charitable trusts contained in Finance Bill, 2021. The proposals are aimed at resolving few anomalies, plug loopholes and eliminate possibilities of double taxation while calculating accumulation of income. The Clause –(5) and (6) of the Bill relates to the proposals concerning public charitable trust.

3.0 Proposals relating to Voluntary Contributions

3.1 Till the assessment year 1972-73, there was no provision deeming voluntary contributions to be income of a Trust, generally except for section 12(2) which deemed donations received from other trusts to be income derived from trust property for the purposes of section 11. Sec 2(24)(iia) provides that the term "income" includes voluntary contributions received by the entities like wholly or partly religious or charitable trusts, university, hospitals, schools etc. exempt u/s 10(23C)(iiid)/(vi)/via). The scheme of taxation of public charitable or religious trust or institution is that section 11, subject to other provisions, grants exemption from the levy of income-tax with respect to the income from property held for charitable or religious purposes. The section contemplates the computation of the income in a commercial manner and provides for accumulation or set apart for application. It is, therefore, necessary for AO to identify the property held in trust. Then, he will have to ascertain the income derived from the said properties of the trust and after ascertaining the income, he will have to examine whether any part of the said income has been accumulated for application. Such accumulation could be only up to a maximum, of 15 % of the income from the property. This provision itself shows that to the extent of 85

% of the income, there has to be an application of the income for charitable purposes. The trust may derive income from the trust property in the form of corpus donation.

3.2 In case of Trust the voluntary contributions can be divided into corpus donations, anonymous donations and other donations. The corpus donations are donations which are received with specific direction from the donor that the donation shall form part of corpus of the Trust. Refer to *CIT v. Sthanakvasi Vardhaman Vanik Jain Sangh (260 ITR 366) (Guj).* Later on Direct Tax Laws (Amendment) Act, 1989 w.e.f. 1-4-1989 inserted clause-(d) to sec. 11(1) of the Act whereby any income in the form of voluntary contributions made with specific directions that they shall form part of corpus of the trust or institution shall not be included in the total income of the previous year of the person in receipt of such income. Thus sec 11(1) (d) grants an unqualified exemption for donations to corpus irrespective of the provision in the trust deed authorizing to apply whole or part of it. At the same time as held by Delhi bench of Tribunal in case of *ITO v. Abhilash Kumari Charitable Trust (1987)(28 TTJ 523)* the corpus donation can be applied towards the objects of the Trust and that such application would qualify for exemption u/s 11. Recently, in case of *DCIT v. Shree Surat Jilla Leuva Patidar Samaj Trust (176 ITD 69)(SRT)*, it is held that if a donor while making the donations make it clear that the donation so made shall form part of the corpus of the Trust, it would be capital receipts and shall not be chargeable to tax. Consequently, the provisions related to accumulation of income and setting apart of that would not apply in such cases. This resulted into double benefit to the trust in the sense that the corpus donation were claimed exempt u/s.11(1)(d) whereas the amount spent/applied from the corpus donation was being claimed as application against the mandatory 85% application of non-corpus income to be made.

3.3 Therefore, the Bill has proposed the amendment to section 11(1)(d) w.e.f. 01.04.2022. It has proposed to substitute the present exemption by inserting the condition that such voluntary contributions are invested or deposited in one or more of the forms or modes specified in sec. 11(5) maintained specifically for such corpus. Thus, in order to claim exemption, in respect of income in the form of voluntary contribution, the trust will have to invest or deposit the same in the forms or modes specified in section 11(5) of the Act. This proposal will also result into locking of funds received in the form of corpus donation as specified investment or deposits. Moreover, the crucial words of this proposal are "maintained specifically for such corpus" which may be interpreted to the effect that the trust has to maintain the corpus donation in a separate account with bank. It will also be required to be clarified whether the trust should maintain separate deposit or investment qua each such corpus donation or maintaining a specific ledger account will suffice the purpose. The intension of the legislature seems that the amount of corpus donation is not utilized but its income is applied for the objects of the trust.

4.0 Proposed clause-(i) of Explanation -4 relating to application from corpus donation.

4.1 The bill also proposes to insert Explanation-4 in order to plug the loop hole of claiming the application out of corpus treated as application against mandatory 85% of non-corpus income. The proposed Explanation-4 provides that the application for charitable or religious purposes from the corpus referred to in section 11(1)(d) shall not be treated as application of income for charitable or religious purposes. However, the proposed proviso to this clause-(i) of Explantion-4, carves out an exception. The proviso provides that in case the amount or part thereof not so treated as application shall be treated as application for charitable or religious purposes in the previous year in which the

amount or part thereof is invested or deposited back into the modes specified in section 11(5) maintained specifically for such corpus.

4.2 The effect of this proviso is that the trust has to make a fresh investment or deposit back of the amount equal to the amount not treated as application. Say for example if the trust has received corpus donation of ₹50 lakhs during F.Y.2021-22, in order to claim it exempt u/s.11(1)(d), the investment or deposit as specified in 11(5) should be made. Now, in case, the amount so received is spent in that year, it cannot be claimed as application against the mandatory 85% application of non-corpus income. However, if the trust invest or deposit back in specified modes, either whole or part of the amount so spent, the amount so invested would be treated as application in the year in which investment or deposit is made. Now, in our example, in case the trust makes investment or deposit either of ₹50 lakhs or part thereof, such amount of investment or deposit shall be treated as application and it can be claimed in the mandatory 85% application. This proposal may create difficulty in a situation where the application out of corpus donation is in one year whereas the reinvestment is in another year. Say for example, the trust has utilized ₹ 10 lakhs out of the corpus donation of ₹50 lakhs so received in F.Y.2021-22 whereas the reinvestment is made in F.Y.2022-23, the trust can claim mandatory application only in A.Y.2023-24 whereas it will not be able to claim it in A.Y.2022-23 which will disturb the financial position. This situation may also result into payment of tax in A.Y.2022-23 whereas, a deficit in A.Y.2023-24 which it will not be able to carry forward and claimed in the subsequent year in view of proposed Explanation-5 of this Bill.

5.0 Proposed clause-(ii) of Explanation -4 relating to application from loan or borrowings.

5.1 The Bill also seeks to remove the anomaly in respect of application out of loans & borrowings and such loan or borrowings when repaid are again claimed as application. This, results in unintended double deduction as stated in the memorandum explaining the Bill. The clause-(ii) of Explanation-4 proposes to disentitle the application out of loan or borrowings but to allow the repayment of loan or borrowing in the year of repayment to the extent of such repayment as application for public trust.

5.2 It is proposed in sub-clause (ii) of proposed Explanation-4 of this Bill that the application for charitable or religious purposes from any loan or borrowing shall not be treated as application of income for charitable or religious purposes. However, the proviso to this sub-clause provides that when the amount, either whole or part is not treated as application, the repayment of such loan or borrowing or part thereof shall be treated as application of income for charitable or religious purposes in the year of repayment and to the extent of repayment. Thus, the proposed Explanation will result into allowance of repayment of loan or borrowing as application of income in the year repayment to the extent so repaid. This proposal is in line with the decision in case of *CIT v. Janmabhumi Press Trust (242 ITR 457)(Mad)* wherein it was held that the repayment of the debt incurred by the trust for construction of the building should be treated as application of the income of the trust for charitable purposes. Similarly, in case of *DIT (Exem.) v. Govindu Naicker Estate (315 ITR 217) (Mad)* wherein it was held that repayment of bank loan taken for construction of commercial complex for augmenting the income of the trust, is an application of income for charitable purpose. **Even CBDT Circular No. 100 dt. 24-01-1973 (88 ITR St.66)** also clarified its stand that the repayment of the loan originally taken to fulfill one of the objects of the trust will amount to an application of the income for charitable and religious purposes.

5.3 The issue that may arise on account of this proposal is whether the application for charitable or religious purposes from fresh

loan or borrowings taken during the FY 2021-22 and subsequent years would be hit or even application out of old c/f loan or borrowing will be covered? It appears that since the law in force at the time of claim of application of income would be applicable, even the application out of old borrowings will be covered. Say for example, the loan or borrowings is taken during FY 2020-21 and it is used for the purposes of charitable or religious purposes during FY 2021-22 as a capital expenditure or on revenue account, the said application will not be allowed in the A.Y. 2022-23 subject to the provision of sec 11(6) in respect of capital expenditure.

5.4 It further appears that in view of this proposed amendment, in case where loan or borrowings are applied for acquisition of any depreciable asset, the cost of such asset will not be admissible as application of income to that extent of loan or borrowing so utilized and at the same time, the claim of depreciation may be admissible because sec. 11(6) disentitles depreciation or other deduction or allowance in respect of any asset, acquisition of which has been claimed as an application of income in the same year or any other previous year. In such situation, it appears the depreciation allowance may be admissible and the proviso to this proposed clause-(ii) of allowing repayment of loan or borrowings in the year of repayment will not be applicable because it comes into play only when the amount is not treated as application of income. Say for example, the trust has borrowed ₹ 50 lakhs during FY 2021-22 and utilized it towards acquiring a depreciable asset, the amount so spent will not be admissible as application of income under the clause-(ii) of Expl-4 of the Bill. Now sec 11(6) disentitles the claim of depreciation on any asset only if acquisition of which is claimed as application of income in any year. In other words, the trust cannot claim double deduction one, by way of application of asset to the extent income used for acquisition of asset and again the depreciation on its cost. Therefore, a combined reading of the clause-(ii) of Expl-4 and sec. 11(6) enables to take a view that (i) the utilization of loan towards acquisition of any asset will not be treated as application of income and as a result, it will render such utilization entitled to depreciation and (ii) repayment of loan or borrowing will be treated as application of income in the year of repayment because the amount applied towards acquisition of asset has not been allowed as application of income by the clause. Now in our example, the borrowed amount of ₹ 50 lacs spent for acquiring the capital asset will not be treated as application under clause-(ii) as a result, claim of depreciation on said ₹ 50 lacs could be made u/s 11(6). Now when repayment of loan starts from next year, it shall be treated as application of income under this proviso and in that case, it is possible to argue that claim of depreciation may not be allowed u/s 11(6). The suitable clarification on this issue is desired.

6.0 Proposal relating to set off of deficit of preceding year/s:

6.1 The next proposal in the Bill relating to taxation of trusts & institution is the insertion of Explanation-5 to disregard deficit of **current** year for adjustment against the income of subsequent year/s. **Hitherto** there is no provision in the Act for the trust that it can carry forward the excess application of the income to be set off against the future income. However the majority of judicial opinion was that deficit arising out of expenditure over income for the previous year should, therefore, be set off against surplus of income over expenditure relating to subsequent year. Refer to *CIT v. Shri Plot Swrtaber Murti Pujak Jain Mandal (211 ITR 293)(Guj); CIT v. Maharana of Mewar Charitable Foundation (1987) (164 ITR 439 (Raj), CIT v. Institute of Banking Personnel Selection (2003)(264 ITR 110 (Bom), CIT v. Siddaramanna Charities Trust (1974) (96 ITR 275 (Mys) and CIT v. Matriseva Trust (2000) (242 ITR 20 (Mad) DIT v. Raghuvanshi Charitable Trust (44 DTR 223)(Del).* The Department did not accept this proposition and had filed SLI in Supreme

Court in the case of *DCIT (Exem.) v. Subros Eduction Society* which was dismissed by order dt. 9-11-2017. It was held in these decisions that where expenses for charitable and religious purposes have been incurred in earlier year and said expenses are adjusted against income of a subsequent year, income of that year can be said to have been applied for charitable and religious purposes in year in which expenses has been adjusted. It was further held that income derived from the trust property has to be determined on commercial principles and if commercial principles for determining the income are applied, it is but natural that the adjustment of the expenses incurred by the trust for charitable and religious purposes in the earlier year against income earned by the trust in the subsequent year will have to be regarded as application of income of the trust for charitable and religious purposes in the subsequent year in which such adjustment has been made having regard to the benevolent provisions contained in section 11 and will have to be excluded from the income of the trust under section 11(1)(a).

Now the proposal in this Bill by way of Explanation-5 puts at rest this controversy in favour of Department.

6.2 Now the proposed Explanation provide that while computing the income to be applied or accumulated during the previous year shall be made without any set off or deduction or allowance of any excess application of any of the preceding previous year. The result would be that such deficit will become a dead loss to the Trust.

6.3 Now the issue may arise in relation to deficit arising on account of excess application out of corpus donation or non-corpus donation/ future income. Where the Trust or institution expends or applies more than its income in any year, it can mean that such excess amount is from corpus donation or future income. The intention should be manifest from the accounts. Now, in view of the Explanation-4 to sec 11(1) proposed by the Bill, the application for charitable or religious purposes from corpus donation is not to be treated as an application so that such amount spent or applied will not be eligible for c/f and set off against income of succeeding year/s. Hence is it possible to contend that excess application on revenue account by way of outstanding creditors for expenses can be set of in succeeding year when they are actually paid off?

6.4 Moreover, when there is reinvestment or deposit of amount applied from corpus donation which is to be treated as application in the year of investment or deposit as per proviso to clause-(i) of Expl-4, can deficit arising on account of such application be set of in next year/s ?

6.5 It is submitted that proposed Expl-5 provides for blanket rejection of such deficit of any preceding year/s against the current year because the words used in this Explanation are "any set off or deduction or allowance". Therefore once any amount has gone into the composition of application in any of the preceding year, the same shall not be included in the calculation of application for the current year. It is desired that suitable relief should be allowed in cases where there is actual payment/ application which has generated deficit.

7.0 Proposals relating to funds or trust or institution u/s 10(23C)

7.1 Section-10(23C) provides for exemption of income received by any person on behalf of different funds or institutions etc. specified in different sub-clauses. The sub-clauses (iiiad) of clause (23C) of section 10 provides for the exemption for the income received by any person on behalf of university or educational institution existing solely for educational purposes and not for the purposes of profit if the aggregate annual receipts of such educational institution do not exceed the

amount of annual receipt, presently, of ₹ 1 cr. as per Rule-2BC of the IT Rules. Similarly, the sub-clauses (iiiae) of clause-(23C) of the said section provides for exemption in respect of income received by any person on behalf of hospital or institution as referred to therein provided the annual receipts of such hospital or institution does not exceed ₹ 1 cr. as per said Rule.

7.2 Now, the Bill proposes a welcome amendment by way of increasing the limit to ₹5 cr. and such limit shall be applicable to an assessee with respect to the aggregate receipts from university or educational institution etc. as referred to in said sub-clauses. This amendment will take effect from 01.04.2022 and accordingly apply to A.Y.2022-23 and subsequent assessment years. The close reading of the proposed amendment indicate that the upper ceiling of ₹5 cr. is the aggregate annual receipts of such university or educational institution etc. instead of the limit applicable to each university or other educational institution of the assessee and this may result into the benefit becoming illusory. It may be stated that the assessee may be having number of educational institutions running different educational courses say engineering or commerce or arts faculty. It is suggested that when a beneficial amendment is going to be made by way of increasing the upper limit of receipts, it should have been made applicable from A.Y.2021-22 just as many of the proposals of the Bill has been made applicable from A.Y.2021-22.

7.3 Under the existing provisions of the Act, the third proviso to section 10(23C) provides that the income in the form of voluntary contribution made with a specific direction that they shall not form part of the corpus of such fund or university or other educational institution etc. This Explanation was inserted by the Finance Act, 2020 w.e.f. 01.04.2020 but in view of the amendments proposed in this Bill in respect of voluntary contributions and application or accumulation of income for specified purposes u/s. 11(1) of the Act, the consequential amendment has been proposed in respect of the funds or trust or institution covered under section 10(23C)(iiiad) and (iiiae) w.e.f. 01.04.2022.

8.0 To conclude, the tax provisions applicable to charitable or religious trust have become increasingly complex and it has become difficult for the small trust, more particularly religious trust to comply with various procedural formalities and it may have to pay a high price. While one certainly appreciates that an exemption from payment of taxes does not come without duties that one has to discharge, the law in this regard must be administered with a human touch. The provisions relating to charitable or religious trusts or institutions should be interpreted in a manner that it advances the objects and encourage philanthropic activities which are badly needed in this country. Hon. Finance Minister in her budget speech, at para-170 has stated that "we hope to reduce compliance burden on small charitable trust running educational institution and hospitals".

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