CAN A TRUST BE TAXED AT MAXIMUM MARGINAL RATE AND WITHOUT ALLOWING EXPENSES?

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There are many issues in preparing and validating the ITR7. I have tried to analyse one important issue in the present ITR7.

1. Tax rate applicable

I am considering the issue only for those trusts which are registered under sec.12A/12AA/12AB and are public charitable trusts having no business activity and/or income from business and have not violated any condition u/s 13.

The ITR7 does not provide any space or column for the trusts to be taxed at normal slab rates and validation compulsorily asks to enter the taxable amount, if any, in the column with tax @30% i. e. MMR. Otherwise, the validation rules do not validate the ITR and it cannot be uploaded.

This is perhaps the most illegal and illogical issue arising in the trust returns.

1.01 Tax rates applicable is specified in Sec. 2(37A) which states that "rate or rates in force" or "rates in force", in relation to an assessment year or financial year, mean the rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year, or as specified under specific sections, which includes Sec.167B also.

Finance Act states that-

(I) In the case of every individual other than the individual referred to in items (II) and (III) of this Paragraph or Hindu undivided family or association of persons or body of individuals, whether incorporated or not, or every artificial

juridical person referred to in sub-clause (vii) of clause (31) of section 2 of the Income-tax Act, not being a case to which any other Paragraph of this Part applies,—

(See- THE FIRST SCHEDULE (*See* section 2) *PART I,* INCOME-TAX, *Paragraph A*- to the Finance Act, 2023).

This is given in every Finance Act.

Income Tax portal under the information for Trust specifies in a question answer format as under -

What is the tax rate?

A trust is chargeable to tax as per the slab rates which are applicable to an individual (not being a senior citizen or super senior citizen).

(https://incometaxindia.gov.in/Pages/i-am/trust.aspx?k=Tax%20Payment)

1.02 Thus, it is clearly specified that the trusts shall be charged tax at the rates specified for individuals, i. e. with slabs and basic threshold limit not chargeable to tax, which is at present Rs.2,50,000.

1.03 In the notified ITR7 Form, there is no provision to disclose 'Income taxable at normal rates' in Part B-TI Part B1 (i.e., if return filed u/s 139(4A) / approved u/s 10(23C) (iv) to (via) cases). Also, as per ITR-7 instructions, in case of Part B1 of Part B-TI, the Total Income shall be taxable at 30%.

Not only this, but while validating the ITR, the validation rules give an error message that-

There is no provision to disclose 'Income taxable at normal rates' in Part-B TI Part-B1 of ITR-7. Please include the same in 'Income taxable u/s 115BBI @30%' row of 'Tax on total income' table.

One of the ITR software (Winman) gives suggestion to –

> Please include normal income in 'Income taxable u/s 115BBI @30%' row of 'Tax on total income' table (delete the amount against 'Income taxable at normal rates' and paste it against 'Income taxable u/s 115BBI @ 30%' by converting the cell into input) and re-generate the return.

Thus, virtually the law on the subject is clearly set aside and the portal and its utility software are trying to implement and tax at the rates not specified under the law.

Not only this but the ITR validation rules do not allow the basic exemption limit or the maximum amount not chargeable to tax i. e. Rs.2,50,000 and charges entire amount at 30%. For example, if a trust is having say income of Rs.3,00,000 after deducting the expenses and basic 15% u/s 11(1), the tax is Rs.93,600 i. e. 30% tax plus 4% cess.

Clarification sought by software companies are not yet replied by the help desk.

1.04 Question is when the income of a trust is taxable @ MMR?

The tax at MMR is provided in Sec. 167B which reads as under -

S. 167B. Charge of tax where shares of members in association of persons or body of individuals unknown, etc.—

(1) Where the individual shares of the members of an association of persons or body of individuals (other than a company or a co-operative society or a society registered under the Societies Registration Act, 1860 (21 of 1860), or under any law corresponding to that Act in force in any part of India) in the whole or any part of the income of such association or body are indeterminate or unknown, tax shall be charged on the total income of the association or body at the maximum marginal rate:

Provided that, where the total income of any member of such association or body is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on the total income of the association or body at such higher rate.

(2) Where, in the case of an association of persons or body of individuals as aforesaid [not being a case falling under sub-section (1)],—

(i) the total income of any member thereof for the previous year (excluding his share from such association or body) exceeds the maximum amount which is not chargeable to tax in the case of that member under the Finance Act of the relevant year, tax shall be charged on the total income of the association or body at the maximum marginal rate;

(ii) any member or members thereof is or are chargeable to tax at a rate or rates which is or are higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the association or body which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income of the association or body shall be taxed at the maximum marginal rate.

Explanation.—For the purposes of this section, the individual shares of the members of an association of persons or body of individuals in the whole or any part of the income of such association or body shall be deemed to be indeterminate or unknown if such shares (in relation to the whole or any part of such income) are indeterminate or unknown on the date of formation of such association or body or at any time thereafter.

The section provides a condition to apply the MMR subject to the condition that the share of members of the AOP, BOI or AJP must be indeterminate or unknown.

It further carves out exception for-

1) *a company or*
2) *a co-operative society or*
3) *a society registered under the Societies Registration Act, 1860 (21 of 1860), or*
4) *under any law corresponding to that Act in force in any part of India*

Any public charitable trust is created for either the benefit of public at large or for benefit of a specific section of public. In either of the cases, the persons/individuals for whom the trust is created do not have any "vested share" in the income of the trust neither any member of the trust has any such "vested share".

Obviously, therefore, the question of the share being indeterminate or unknown does not arise.

I may divulge here for an issue - whether a trust registered under the Maharashtra Public Trust Act 1950 (MPT Act) is covered under the fourth limb of exception u/s 167B i. e. under any law corresponding to Societies Registration Act 1860 (SR Act).

For the information I may state here that, if a trust applies for Registration under the SR Act in Maharashtra it is automatically eligible to be registered under the MPT Act and get the registration certificate under both the Acts.

In an interesting old case before Hon. Bombay High Court, an issue arose as to whether the Bombay Public Trusts Act, 1950, applies to a society registered under the Societies Registration Act, 1860, especially when the objects are not confined to the state?

After thoroughly analysing the provisions of both the Acts as well as the Constitution of India, Hon. HC concluded that-

I hold, agreeing with my brother Patel, J., that the Bombay Public Trusts Act, 1950, applies to the appellant-Society, though it is registered under the Societies Registration Act and has its objects not confined to one State.

Please see- **Servants of India Society vs Charity Commissioner of Bombay,** 8 November 1960**: AIR 1962 Bom 12, (1961) 63 BOMLR 379, ILR 1961 Bom 381.**

Thus, a trust registered under the MPT Act can be considered as registered under the fourth limb of exception u/s 167B.

1.05 Further not only the ITR, but the CPC is charging the tax at MMR while processing the returns u/s 143(1) of the trusts, even in the case where the trust is not registered u/s12A/12AA/12AB.

Apparently when the charitable trust is not registered u/s 12A of the Income Tax Act, 1961, the provisions of Sec. 14 would apply for the purpose of computation of income of the trust.

Further, as per Sec. 14, income of the trust would normally fall under the residuary head of income i. e. “Income from Other Sources” and the provisions of Sec. 56 will trigger and hence, the trust would not be entitled to deduction of the expenses incurred unless it is “laid out or expended wholly and exclusively for the purpose of making or earning such income” as per Sec. 57. Obviously, the expense is never for earning such income.

This puts the trusts into a great loss and risk as the gross income would become chargeable to tax, instead of the net income.

Further the trust is treated as AOP if the ITR is not filed in the status of a trust and MMR is applied.

2. Legal precedence

2.01 In one old case the argument of the assessee trust was not accepted under peculiar facts of that case where the Hon. ITAT Bangalore held against the trust in-

Basil Mendes Memorial Educational and Charitable Trust vs. ITO, dt.14-09-2018, 173 ITD 390.

In this case For AY 2011-12 the return was filed in form ITR-5 with the status of AOP and income was declared under the head Business and Profession.

The AO observed that – The assessee has claimed status of AOP and not of trust in the return of income filed by the assessee for the present year. The AO has concluded on this basis that as the status of assessee is treated as "AOP" for tax purposes, the section applicable is s. 164(1) and therefore, maximum marginal rate of tax is proper in the present case.

Before Hon. ITAT, the assessee trust in its second argument claimed that S. 167B is not applicable. But Hon. ITAT observed that –

1) There is no exception provided to trusts u/s 167B.
2) As per trust deed, trust should be irrevocable but trustees at any time in their discretion and for better fulfillment of objects of trust may dissolve trust and distribute funds and properties of trust to such institution or persons, as they may decide and approved by objects of trust. Therefore, it cannot be said that the trust fund cannot be used by the trustees at all.
3) Share of trustees in trust fund was not known and it was indeterminate.

This judgment of Hon. ITAT is based on specific facts of the case and cannot be applied to each case.

Not only this, but with due respect, the second condition observed by Hon. ITAT is not correct. This is because now a days the CIT Exemption while granting registration u/s 12A/AA/AB, requires the trusts to have a

dissolution condition compulsorily to provide to merge the trust or give the trust properties to other trust with similar objects. Treating this condition as providing option to the trustees to utilize trust funds is certainly ridiculous and not in line with the law.

2.02 Another case is decided against the assessee by Hon. ITAT Delhi in **Air Force Navy Farm Owners Welfare Association vs ITO, (2020) 183 ITD 0611 (Delhi-Trib).**

The 99 (Ninty-nine) Air-Force and Navy Officers constituted an association for management of farmhouses allotted to them by the Air Force Naval Housing Board. This association was registered under the Society Registration Act, 1860 and as owners are fixed, shares are not indeterminate. The association claimed its functioning on the concept of mutuality without indulging in any business activity. The society had obtained PAN in the status of AJP.

For AY 2013-14 interest income was declared. But the AO held it as AOP and taxed the interest being from outsiders/non-members at MMR u/s 167B.

In the first round Hon. ITAT remanded the case to the AO to examine the applicability of section 167B.

In the second round, the AO applied the tax rate applicable in the case of cooperative society without providing any benefit of basic threshold limit. FAA confirmed AO's order declining basic exemption limit and holding 167B applicable.

ITAT observed that in the second round the assessee had challenged the status as AOP which was not challenged in the first round.

The Ld. CIT(A) had reproduced, the provision of section 167B of the Act and, thereafter, proceeded to hold that, in the case of the assessee provision of section 167B (2) are applicable. The section 167B(2) prescribe that in case of any Association of Person (not being a case falling under subsection 1 of 167B), if total income of the any member of the Association of Person (excluding the share from such Association) exceeds the maximum amount, which is not chargeable to tax under the Finance Act of the relevant year, the tax shall be charged on the total income of the Association at

maximum marginal rate. In view of the provision, the Learned CIT(A) held that income of the members being in the slab of maximum rate of tax, the society is not entitled to the benefit of exemption from the minimum amount and liable to the incidence of maximum marginal rate income of section 167B(ii) of the Act.

Hon. ITAT held that- In our opinion, the finding of the Learned CIT(A) on the issue in dispute is well reasoned. A society registered under the Societies Registration Act, 1860, has been excluded from the provision of section 167B9(1). Thus, in case of any society, which, though has been held as Association of Person and income of such Association is indeterminate; such society will be excluded from invoking of maximum marginal rate. But, the provisions of section 167B(2) are applicable in the case of Association of persons not being a case falling under sub-section 1.

ITAT specifically observed that - the assessee has not disputed the finding of the Learned CIT(A) that income of its member during the year under consideration exceeds the basic exemption limit.

2.03 Hon. Rajasthan High Court u/s 143(1) under old provisions-

JKs Employees Welfare Fund vs ITO, (1993) 199 ITR 0765

When the processing power was with the AO, Hon. Rajasthan High Court had to decide whether 167B can be applied in prima facie adjustments to be made u/s 143(1) by the AO for AY 1991-92 and it observed that, Sec. 143(1)(a) contemplates that power could be exercised only under specified circumstances and held that,

it has been mentioned in para 8 that the 'return of income filed by the assessee for the asst. yr. 1991-92 did not mention any reason for applying any rate other than those prescribed in s. 167B, and, therefore, the tax was charged as prescribed under s. 167B'. No doubt, the assessee has not mentioned the reasons as explained by the respondents, but has, at the same time, not submitted that the provisions of s. 167B are applicable. For applying the provisions of s. 167B, it was incumbent on the ITO to have provided an opportunity to the assessee and then he should have framed the assessment under s. 143(3). The provisions of s. 143(1)(a) cannot be invoked and the jurisdiction being limited for disallowing only prima facie inadmissible

deductions, allowances, etc., the ITO was not justified in sending intimation creating the demand by applying a provision, the application of which itself was disputed one.

2.04 Important and well-reasoned order giving complete analysis of the issue-

However, Hon. ITAT for AY 2013-14, 2014-15 to 2016-17, in the case of **Sanatan Dharam Mandir Sabha vs. ITO, (2022) 65 CCH 0079 DelTrib,** has ruled in favour of the assessee. The assessee was registered under the Societies Act but not u/s 12A. CPC Bangalore processed the ITR7, u/s 143(1) and disallowed expenses and without allowing threshold limit, taxed entire gross receipts at MMR.

The 154 application was rejected holding that for AOP there is no threshold limit without giving any reason for disallowing expenses.

Before CIT(A), status of AOP, disallowance of expenses, threshold limits and tax at MMR were challenged.

She held that for the assessee tax rate will be that of individual and threshold allowed, as the appellant is a charitable trust which is registered under the Societies Registration Act, 1890. Therefore, section 167B of the I.T. Act will not be applicable, and the rate at which an unregistered charitable or religious trust or institution is taxed will be the rate that is applicable to individual assessee except for those that are covered u/s 13(1) of the I.T. Act. Consequently, the threshold limit too was allowed.

However expenses were disallowed holding that, as per Sec. 2(24)(iia) entire voluntary contribution received by a trust is income and no allowance will be made for deduction from such income. Also, when the income received in the form of voluntary contribution has been shown and assessed under the head 'Income from Other Sources', then the relevant section i. e. section 57 of the I.T. Act has to be followed for giving effect to any deduction from such income which does not allow expense if it is not incurred for earning the relevant income.

Hon. ITAT observed that, A perusal of the case shows that the adjustment made by the CPC, Bangalore, does not fall under any of the limbs prescribed u/s 143(1) of the Act. Further, the submission of the ld. Counsel that no

such adjustment was made in earlier Assessment Years and there is no change in the facts during the year under consideration, also could not be controverted by the ld. DR.

Hon. ITAT placed on record the observations of Hon. Delhi High Court in the case of **DDIT (E) vs Petroleum Sports Promotion Board, [2014] 362 ITR 235 (Del.)** -that,

> It is open to the income-tax authorities to deny the exemption under Section 11 of the Act in the absence of registration under Section 12A and if they do so, then the assessment has to be completed in accordance with the provisions of the Income Tax Act; if the income is assessed under the residual head full play must be allowed to Section 57(iii).
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> Though prima facie, the phraseology employed in Section 57(iii) is different from Section 37(1), it has been held by the **Supreme Court in CIT vs. Rajendra Prasad Moody, 115 ITR 519** that Section 57(iii) must be construed broadly and the somewhat wider language of Section 37(i) should not affect the interpretation of Section 57(iii).

Hon. ITAT also upheld the argument of the assessee that, the adjustment so made by the CPC, Bangalore without assigning any reason is contrary to provisions of section 143(1) of the Act and that in case of charitable society, even if benefit u/s 11 and 12 of the Act is denied and its income was brought to tax as "Income from Other Sources", all relevant expenditures are also to be allowed under section 57(iii) of the Act. A perusal of the same shows that the adjustment made by the CPC, Bangalore, does not fall under any of the limb prescribed u/s 143(1) of the Act and that no such adjustment was made in earlier Assessment Years and there is no change in the facts during the year under consideration, also could not be controverted by the ld. DR.

Hon. ITAT also relied on the observations in the case of **DDIT (E) vs Petroleum Sports Promotion Board, 2014] 362 ITR 235 (Del.)** -that,

> "The expenditure incurred by the assessee is only for the purpose of promoting the sports events and activities and in this respect, there is no challenge to the finding of fact recorded by the Tribunal. If such

expenditure is not allowed, it may amount to taxing the gross receipts of the assessee and not the income, which is not permissible under the income tax law. Moreover, upto the assessment year 2002-03 the assessee was exempt from tax under Section 10(23C); from the assessment year 2006-07 it has been granted registration for a charitable institution under Section 12A making it eligible for the exemption under Section 11."

Hon. ITAT member held that in view of the above discussion, I am of the considered opinion that the adjustment made by the CPC, Bangalore, and confirmed by the ld. CIT(A) is not warranted being contrary to provisions of section 143(1) of the Act. Accordingly, the order of the Ld. CIT(A) is set-aside, and the AO is directed to allow the claim of expenditure from the gross receipt.

2.05 Delhi High Court judgment confirming in favour of the assessee-

In case of AY 2014-15 in case of **Sri Guru Singh Sabha vs. DCIT, (2023) 224 DTR 0165 (Del)** following were the facts-

Assessee registered under the Societies Registration Act, 1860 but applied and but not registered under 12A, received Rs. 5,07,274/- towards offerings on account of 'Gurupurab and Kirtan Darbar' and incurred expenses of Rs. 3,22,837/-. on Kirtan and Darbar. In the ITR status was shown as AOP. CPC and AO assessed and taxed entire gross receipts at MMR u/s 167B. Exemption u/s 11 and 12 was not allowed being not registered u/s 12A.

CIT(A) only allowed building fund from the income and rejected all the other grounds. Hon. ITAT confirmed CIT(A)'s order.

Hon. HC, after analyzing Sec. 167B, held that the appellant/assessee was registered as a society as far back as on 10.02.1978 under the 1860 Act. If this position is correct, then on a plain reading of Section 167B of the Act, one can only conclude that the maximum marginal rate cannot be made applicable.

It further observed and held that the assessee was responsible for its own woes for stating itself as AOP. However, CIT(A) failed to exercise its power when a specific ground in appeal was raised that the appellant was constituted as a society and hence, the MMR could not have been applied.

It further upheld the contention of the assessee that only surplus is taxable, as income and not the gross receipts. Further that in the succeeding year the CPC itself had allowed the expense and had taxed only the net income.

Hon. HC has also remarked that since the return of the appellant/assessee was processed under Section 143(1) of the 1961 Act, if there were any doubts, scrutiny should have been carried out and the necessary powers available under the 1961 Act should have been taken recourse to.

The questions of law are decided in favour of the appellant/assessee and against the respondent/revenue.

3.00 Take aways from the discussion –

1) PAN – Check your PAN card and if it is obtained in the capacity of an AOP, then it needs to be changed if exemption is to be claimed, otherwise it may pose issues in processing as well as assessments. Change may involve other issues and additional issues may arise in the process.

2) Status – Carefully select the status of Trust while uploading the return.

3) ITR Form – From AY 2022-23 assessee claiming exemptions under sections mentioned below can file ITR 7-

Return to furnish u/s	139(4A)	139(4B)	139(4D)
Exemption claim u/s	11	13A, 13B	10(21) read with 35(1)

Return to furnish u/s	139(4C)					
Exemption claim u/s	10(21)	10(22B)	10(23A)	10(23B)	10(23C)(iiiab)	10(23C)(iiiac)
	10(23C)(iiiad)	10(23C)(iiiae)	10(23C)(iv)	10(23C)(v)	10(23C)(vi)	10(23C)(via)
	10(23D)	10(23DA)	10(23FB)	10(24)	10(46)	10(47)
	10((23AAA)	10(23EC)	10(23ED)	10(23EE)	10(29A)	

4.0 Trusts not registered u/s 12A/12AA etc.

There are issues about ITR form in case of a trust not registered u/s 12A/12AA etc. and income after deducting expense is below taxable limit. These trusts are compelled to file ITR5 and CPC raises tax demands taxing entire gross receipts at MMR.

For this as well as the issue of rate of tax compelled at 30%, the ITR as well as the validation rules need amendments. We hope that Hon. the CBDT, CPC, and Hon. Finance Minister will look into the matter urgently.