

**Gautam Nayak**

**Chartered Accountant**

# **Taxation of Charitable Trusts – Recent Issues**

**Bombay Chartered Accountants' Society**

**15<sup>th</sup> January, 2014**

# Issues

- Loss of Exemption due to Section 2(15) proviso
- Advancement of Any Other Object of General Public Utility
  - Activity in the nature of trade, commerce or business
  - Activity in relation to trade, commerce or business
  - Taxation of Trade Organisations
  - Cancellation of s.12AA registration due to applicability of s.2(15) proviso
- Meaning of term “education”
- S.12AA Registration – Carrying on of Activity before Registration
- Taxability of Corpus Donations
- Deductibility of Depreciation

# Issues

- Issues Raised in Recent CAG Report
  - Lapses in Registration Process – Winding up Clause
  - Accumulations
  - Non-monitoring of foreign contributions received
  - Other Issues

# Section 2(15) Proviso

- **Advancement of Any Other Object of General Public Utility**
- Explanatory Memorandum to Finance Bill, 2008
  - *It has been noticed that a number of entities operating on commercial lines are claiming exemption on their income either under s.10(23C) or s.11 of the Act on the ground that they are charitable institutions. This is based on the argument that they are engaged in the “advancement of an object of general public utility” as is included in the fourth limb of the current definition of “charitable purpose”. Such a claim, when made in respect of an activity carried out on commercial lines, is contrary to the intention of the provision.*
  - *With a view to limiting the scope of the phrase “advancement of any other object of general public utility”, it is proposed to amend s.2 (15) so as to provide that “the advancement of any other object of general public utility” shall not be a charitable purpose if it involves the carrying on of .....*

## Section 2(15) Proviso

- **Advancement of Any Other Object of General Public Utility**
- Finance Minister's Speech while moving amendments
  - *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 an 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"*

# Section 2(15) Proviso

- **Advancement of Any Other Object of General Public Utility**
- CBDT Circular No 11 of 2008 dated 19.12.2008
  - *a number of entities who were engaged in commercial activities were also claiming exemption on the ground that such activities were for the advancement of objects of general public utility in terms of the fourth limb of the definition of 'charitable purpose'. Therefore, s.2(15) was amended..*
  - *where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute 'charitable purpose' even if it incidentally involves the carrying on of commercial activities*
  - *'Relief of the poor' encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid*

# Section 2(15) Proviso

- **Advancement of Any Other Object of General Public Utility**
- CBDT Circular No 11 of 2008 dated 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'*
  - *Whether such an entity is carrying on an 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 the activity.*
  - *If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to 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*

# Section 2(15) Proviso

- **Advancement of Any Other Object of General Public Utility**
  - Lala Lajpatrai Memorial Trust v DIT(E) 28 ITR (Trib) 546 (Mum)
    - Main object of promotion of education
    - Let out building to others for running educational institutions with intention to promote educational institutions
    - Auditorium meant to be used by educational institutions free of cost – let out for other activities when not required
    - Used by college for 209 days, vacant for 76 days, let out for 80 days
    - Whether proviso to s.2(15) attracted
    - Letting out of auditorium was not dominant object – object was of advancement of education
    - Merely because auditorium was incidentally let out to outsiders for commercial purposes, activity would not fall within advancement of object of general public utility
    - Proviso to s.2(15) not attracted

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**
  - Institute of Chartered Accountants of India v DGIT(E) 347 ITR 99 (Del)
    - Institute cannot be regarded as educational institute as its main or predominant objective is to regulate the profession of & the conduct of CAs enrolled with it
    - Statutory authority under the Chartered Accountants Act, 1949
    - Utilization of the funds or income earned, whether for charitable purpose or otherwise, is not relevant now
    - While construing the term “business” for said section, the object and purpose of said section has to be kept in mind. A very broad and extended definition of the term 'business' is not intended for the purpose of interpreting and applying the first proviso to s. 2(15 ) to include any transaction for a fee or money
    - An activity would be considered 'business' if it is undertaken with a profit motive, but in some cases this may not be determinative.

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**
  - Institute of Chartered Accountants of India v DGIT(E) 347 ITR 99 (Del)...
  - Normally, the profit motive test should be satisfied but in a given case activity may be regarded as business even when profit motive cannot be established/proved.
  - In such cases, there should be evidence & material to show that the activity has continued on sound & recognized business principles, and pursued with reasonable continuity
  - There should be facts and other circumstances which justify and show that the activity undertaken is in fact in the nature of business.

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**
  - Bureau of Indian Standards v DGIT(E) 358 ITR 78 (Del)
    - Statutory Body established under BIS Act brought into existence for harmonious development of activities of standardisation, marking & quality certification, which is its primary & predominant object
    - Taking licence fee for granting marks/certification cannot be said to be done for the purpose of profit – any profit/revenue earned is purely incidental
    - Performs sovereign & regulatory function, in its capacity as an instrumentality of the State
    - Not involved in carrying on any activity in the nature of trade, commerce or business

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**

- Institute of Chartered Accountants of India v DGIT(E) 358 ITR 91 (Del)
  - The expressions “trade”, “commerce” and “business” occurring in first proviso to s.2(15) must be read in the context of intent & purport of s.2(15) and cannot be interpreted to mean any activity carried on in an organised manner
  - The purpose and dominant object for which an institution carried on its activities is material to determine whether the same is business or not
  - The purport of first proviso to s.2(15) is not to exclude entities which are essentially for charitable purpose but are conducting some activities for a consideration or fee
  - Object of introducing first proviso is to exclude organisations which are carrying on regular business from the scope of “charitable purpose”
  - The expressions “trade”, “commerce” and “business” must be interpreted restrictively
  - Where the dominant object of an organisation is charitable, any incidental activity for furtherance of the object would not fall within the expressions

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**
  - Institute of Chartered Accountants of India v DGIT(E) 358 ITR 91 (Del)..
    - Activity of imparting education in the field of accountancy & conducting courses both at pre-qualification & post-qualification level were activities in furtherance of objects for which ICAI was constituted
    - Activities of providing coaching classes or undertaking campus placement interviews for a fee were in relation to main object of ICAI, which cannot be held to be trade, business or commerce
    - Even though fees charged for such activities, activities cannot be stated to be rendering of service in relation to any trade, commerce or business as such activities undertaken in furtherance of its main object, which is not trade, commerce or business

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**
  - CIT v Lucknow Development Authority 219 Taxman 162 (All)
    - Statutory Authority established with object of for development of certain areas and to provide shelter to homeless people within state of UP
    - For applicability of proviso to s.2(15), activities should be carried out on commercial lines with intention to make profit
    - Where activities carried out on non-commercial lines with no motive to earn profits, for fulfilment of its aims & objectives, which are charitable in nature, and in the process, some profits are earned, not hit by proviso to s.2(15)
    - Mere selling some product at profit will not ipso facto attract proviso to s.2(15) to deny exemption – intention of trustees & manner in which activities undertaken are highly relevant to decide the issue
    - No evidence that assessee was conducting its affairs on commercial lines with intention to earn profit
    - Proviso to s.2(15) not applicable

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**
  - Sabarmati Ashram Gaushala Trust v ADIT 25 ITR (Trib) 701 (Ahd)
    - Trust registered with objective of breeding cattle and to improve quality of cows and oxen
    - Sold semen, fodder and milk and earned some profit
    - Only institutions carrying on commercial activities intended to be covered by the proviso, not genuine charitable institutions
    - In order to hold that the activity is in the nature of trade, commerce or business, there should be profit motive
    - If during the course of carrying out any activity on non-commercial lines, some profit is received by the trust, which is incidental to activities of the trust, this shall not be construed to be activity in nature of trade, commerce or business
    - Carried out its activities for fulfilment of its object of breeding cattle and to improve quality of cows and oxen – had sold semen, fodder, milk etc. and in the process earned some profit, which was incidental in nature

# Section 2(15) Proviso

- **Meaning of Trade, Commerce or Business**
  - Sabarmati Ashram Gaushala Trust v ADIT 25 ITR (Trib) 701 ...
    - Objects of trust, purpose and manner of activities of trust, whether to make profit or whether profit earned was incidental to activities of trust, overall facts and circumstances in its entirety, volume of profit received by trust, and whether activities of trust were conducted in a way to fulfil its object, which have essentially to be charitable in nature, and intention of the trustees, all have to be considered to arrive at a just and fair conclusion
    - Cases where profit making is the object should be distinguished from cases, where, although the objects of the trust are wholly charitable, but some profit was made out of the activities undertaken by the trust for the purpose of achieving the objects of the general public utility
    - To decide applicability of the proviso, entirety of facts and circumstances of a case, and in particular the fact whether the activities of the trust are carried out with a motive to earn profit or profit earned was merely incidental while conducting the charitable objects of the trust, have to be considered

# Section 2(15) Proviso

- **In Relation to Trade, Commerce or Business**
  - Andhra Pradesh State Seed Certification Agency v CCIT 356 ITR 360 (AP)
    - Certification of seeds which meets minimum seeds certification standards as per Indian Minimum Seed Certification Standards, 1988
    - Notified as certification agency for the state under section 8 of Seeds Act, 1966
    - Seed growers entered into contract with a society/agent, who approaches assessee for certification – seeds sold to farmers after certification
    - Fee charged for certification
    - Certification of seeds facilitates trade, commerce or business in certified seeds by the client of the assessee
    - Activity is in relation to trade, commerce or business
    - Ignoring words “in relation to trade, commerce or business” not permissible
    - Not a charitable purpose
    - Followed in Punjab State Seed Certification Authority v CIT 144 ITD 671 (Chd)

# Section 2(15) Proviso

- **In Relation to Trade, Commerce or Business**

- **GS1 India v DGIT(E) 262 CTR (Del) 585**

- Institution promoted by Govt for creating awareness & promoting study of global standards re Company Prefix No (GS1 Stds), location numbering, EDI, ECR, automatic data collection and related services & technologies, R & D into these global stds, & providing education in universities/colleges re these stds
- Business Activity has an important pervading element of self interest, whilst charity is antithesis of activity undertaken with profit motive or activity undertaken on sound or recognised business principles
- Charity is driven by altruism and desire to serve others, though element of self preservation may be present
- Small contribution by way of fee that beneficiary pays would not convert charitable activity into business, commerce or trade in absence of contrary evidence
- Not a case of commercial exploitation of IPR & monopoly rights to earn profits, but a case where a token fee payable by user of Global Identification System

# Section 2(15) Proviso

- **In Relation to Trade, Commerce or Business**
  - **GS1 India v DGIT(E) 262 CTR (Del) 585...**
    - Contradictory stand of Revenue that assessee carries on charitable activity, but simultaneously regards the activity as business
    - Intention behind activity is philanthropic, and not to recoup or reimburse in monetary terms what is given to beneficiaries
    - Fee charged & quantum of income earned can be indicative of whether a person is carrying on business
    - Need to keep in mind that charitable activities require operational/running expenses as well as capital expenses to be able to sustain & continue in long run – to be substantially self-sustaining in long run
    - Not necessary that activities to be funded by voluntary contributions
    - Providing services to persons engaged in trade, commerce or business – whether activity in relation to trade, commerce or business
    - Whether legislative intent is to exclude any activity which has the aim & object of providing services to trade, commerce or business

# Section 2(15) Proviso

- **In Relation to Trade, Commerce or Business**
  - GS1 India v DGIT(E) 262 CTR (Del) 585...
    - Not free from doubt – but good reasons to hold that the prohibition is not with reference to the activity of the beneficiaries but activity of the assessee under the residuary clause
    - Intent is to exclude an assessee who carries on business, trade or commerce to feed charitable activities under last limb of definition of charitable purpose
    - Application of income no longer relevant
    - Circular 11 of 2008 does not contradict this – stipulates that object of general public utility should not be mask or device to hide the true purpose, which is trade, commerce or business or rendering any service in relation to trade, commerce or business
    - Beneficiaries of GS1 not restricted to persons from trade, commerce or business, and may include consumers, Govt, beneficiaries of PDS, etc
    - Proviso to s.2(15) not attracted

# Section 2(15) Proviso

- **Taxation of Chambers of Commerce & Trade Organisations**
  - Finance Minister's speech – not be affected by amendment & continue to be regarded as "advancement of object of general public utility"
  - CBDT Circular 11 of 2008
    - Mutuality for dealings with members
    - For dealings with non-members, claim to be charitable organisation now governed by additional conditions
  - S.28(iii) read with s.2(24)(v) & s.44A - income from specific services to members

# Section 2(15) Proviso

- **Taxation of Chambers of Commerce & Trade Organisations**
  - PHD Chamber of Commerce & Industry v DIT(E) 212 Taxman 194 (Del)
    - Chamber of Commerce & Industry, in course of pursuing its objects, rendered several services, such as certification, committee room services, secretarial services & facilities, energy audit, etc. to members & non-members for a fee
    - No doubt that activities are incidental to the attainment of the objects of the chamber
    - Judicial thinking was never in favour of the view that the services performed by a trade, professional or similar association, such as a chamber of commerce and industry, were in pursuit of a business or trade with a profit motive
    - Section 28(iii) has been enacted to ensure that surplus from such specific services does not enjoy any exemption, which would otherwise have been exempt on account of mutuality
    - Since the surplus had to be brought to tax under a particular head, it was thought by the legislature that the head 'profits and gains of business' would be the most appropriate head under which the surplus can be brought to tax.

# Section 2(15) Proviso

- **Taxation of Chambers of Commerce & Trade Organisations**
  - PHD Chamber of Commerce & Industry v DIT(E) 212 Taxman 194 ..
    - This does not, however, mean that a business is carried on by the association in the sense that there is a profit motive which drives the carrying on of the activity
    - services are performed in the true spirit of service to the members of the association (such as a chamber of commerce) and the fees charged are so calculated or fixed that it merely covers the costs incurred by the association in rendering the service. Since accuracy in matching the costs and the fees charged cannot be maintained consistently, there can arise a surplus. The mere arising of a surplus does not clothe the activity of performing the services for the members with a profit motive, which is essential in business
    - The most important feature of business is profit motive. It has not been suggested by the income tax authorities that the activities carried out by the assessee were propelled by any profit motive.

# Section 2(15) Proviso

- **Cancellation of s.12AA registration**
- Amendments by Finance Act 2012 – Explanatory Memorandum
- The 2nd proviso to said section provides that in case where the activity of any trust or institution is of the nature of advancement of any other object of general public utility, and it involves carrying on of any activity in the nature of trade, commerce or business; but the aggregate value of receipts from the commercial activities does not exceed Rs.25,00,000 in the previous year, then the purpose of such institution shall be considered as charitable, and accordingly, the benefits of exemption shall be available to it.
- Thus, a charitable trust or institution pursuing advancement of object of general public utility may be a charitable trust in one year and not a charitable trust in another year depending on the aggregate value of receipts from commercial activities.
- There is, therefore, need to expressly provide in law that no exemption would be available for a previous year, to a trust or institution to which first proviso of sub-section 2(15) become applicable for that particular previous year.

# Section 2(15) Proviso

- **Cancellation of s.12AA registration**
- Amendments by Finance Act 2012 – Explanatory Memorandum
- However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.
- Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable due to application of first proviso on account of commercial receipt threshold provided in second proviso in a previous year. Then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year for which such proviso is applicable. Such denial of exemption shall be mandatory by operation of law and would not be dependent on any withdrawal of approval or cancellation of registration or a notification being rescinded.
- It is, therefore, proposed to amend section 10(23C), section 13 and section 143 of the Act to ensure that such organization does not get benefit of tax exemption in the year in which it's receipts from commercial activities exceed the threshold whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded.

# Education

- **Whether Education necessarily means recognised educational institution alone**
- Sole Trustee, Loka Shikshana Trust 101 ITR 234 (SC)
  - The word “education” connotes the process of training and developing the knowledge, skill, mind and character of students by normal schooling and has not been used in the wide and extensive sense according to which every acquisition of further knowledge constitutes education
  - The sense in which the word ‘education’ has been used in section 2 (15) is the systematic instruction, schooling or training given to the young in preparation for the work of life. It also connotes the whole course of scholastic instruction which a person has received

# Education

- **Whether Education necessarily means recognised educational institution alone**
- Sole Trustee, Loka Shikshana Trust 101 ITR 234 (SC).....
  - Although the term 'education', as used in section 2(15) of the Act, seems wider and more comprehensive than education through educational institutions, such as universities, whose income is given an exemption from income-tax separately under section 10(22) provided the educational institution concerned does not exist for purposes of profit, yet it seems to me that the educational effects of a newspaper or publishing business are only indirect, problematical, and quite incidental so that, without imposing any condition or qualification upon the nature of information to be disseminated or material to be published, the mere publication of news or views cannot be said to serve a purely or even a predominantly educational purpose in its ordinary and usual sense.

# Education

- **Whether Education necessarily means recognised educational institution alone**
- Gujarat State Co-operative Union v. CIT 195 ITR 279 (Guj)
  - The Supreme Court, in the above observations, by referring to the systematic instruction, schooling or training given to the young has only cited an instance in order to indicate as to what the word "education" appearing in section 2(15) of the Act which defines "charitable purposes" is intended to mean. We are certain that these observations were not intended to keep out of the meaning of the word "education", persons other than "young". The expression "schooling" also means "that schools, instructs or educates" (The Oxford English Dictionary, Vol. IX, page 217). The Supreme Court has observed that the word "education" also connotes the whole course of scholastic instruction which a person has received.
  - This clearly indicates that the observations of the Supreme Court were not intended to give a narrow or pedantic sense to the word "education"

# Education

- **Whether Education necessarily means recognised educational institution alone**
- Gujarat State Co-operative Union v. CIT 195 ITR 279 (Guj).....
  - By giving further illustrations of a traveller gaining knowledge, victims of swindlers and thieves becoming wiser, the visitors to night clubs adding to their knowledge the hidden mysteries of life, the Supreme Court has indicated that the word "education" is not used in a loose sense so as to include acquisition of even such knowledge. The observations of the Supreme Court only indicate the proper confines of the word "education" in the context of the provisions of section 2(15) of the Act. It will not be proper to construe these observations in a manner in which they are construed by the Tribunal when it infers from these observations, in para 17 of its judgment, that the word "education" is limited to schools colleges and similar institutions and does not extend to any other media for such acquisition of knowledge. The observations of the Supreme Court do not confine the word "education" only to scholastic instructions but other forms of education also are included in the word "education".

# Education

- **Whether Education necessarily means recognised educational institution alone**
- Gujarat State Co-operative Union v. CIT 195 ITR 279 (Guj)....
  - As noticed above, the word "schooling" also means instructing or educating. It, therefore, cannot be said that the word "education" has been given an unduly restricted meaning by the Supreme Court in the said decision.
  - Though in the context of the provisions of section 10(22), the concept of education need not be given any wide or extended meaning, it surely would encompass systematic dissemination of knowledge and training in specialized subjects. The question whether an educational institution is existing solely for educational purposes can be decided with reference to the activities actually carried on by it. Advancement of knowledge brings within its fold suitable methods of its dissemination and though the primary method of sitting in a class-room may remain ideal for most of the initial education it may become necessary to have a different outlook for further education. It is not necessary to nail down the concept of education to a particular formula. Its progress lies in acceptance of new ideas and development of appropriate means to reach them to the recipients.

# Education

- **Whether Education necessarily means recognised educational institution alone**
  - Saurashtra Education Foundation v. CIT 273 ITR 139 (Guj)
  - It is significant to note that while a trust holding property for the charitable purpose of education as defined by s.2(15) may also be an educational institution existing solely for the purpose of education, the two institutions cannot be treated as belonging to the same class. An institution may be carrying on educational activities as are being carried on by the assessee herein without imparting formal education and without being affiliated to or accountable to any authority. Such a trust can certainly be considered as qualifying for exemption under s.11(1)(a) read with s.2(15), but the term “the educational institution” contemplated by s.10(22) is a narrower concept. Though “educational institution” and educational activities are closely interconnected ; in s.11(1)(a) read with s.2(15) it is the activities which are in focus whereas in s.10(22) both the institution and the activities are in focus. An educational institution under s.10(22) is, therefore, more than a body carrying on charitable activities in the field of education as contemplated by s.2(15)

# Education

- **Whether Education necessarily means recognised educational institution alone**
  - Indian Institute of Bankers v. Dy. DIT(E) 74 TTJ (Mum) 523
  - It is no doubt true that there is no formal school or college in the sense in which we understand modern schools or colleges—fixed hours of study, lunch recess, principal, staff, playground, rules for discipline and the like—but that is no ground for holding that the activities pursued are not educational activities. There is no requirement in s. 10(22) that the assessee should run a school or college in the formal sense in order to qualify for the exemption.
  - The assessee before the Court was publishing a newspaper and the contention was that it was a charitable object, the object being the spread of education. The Court negated the contention and observed that any kind of education, such as the education one may get by reading a newspaper, is not contemplated by the provision and what was contemplated is formal instruction in a particular sphere of human activity. But even in this judgment there is nothing to suggest that the Court meant to convey that educational activities could be pursued only in a formal atmosphere such as a school or a college in the sense in which we know them.

# Education

- **Whether Education necessarily means recognised educational institution alone**
  - DIT(E) v National Safety Council 305 ITR 257 (Bom)
  - Objects of educating the public in regard to safety, protection and health among industrial workers, to organise and conduct programmes, lectures, conferences and other activities for promoting free discussions on all matters and questions relating to safety measures, procedures and research, to conduct educational campaigns with a view to arouse and maintain public opinion and interest of the employers and workers and their support to safety and accident prevention and to encourage all persons and other associations to adopt, institute and support safety measures and accident prevention programmes, amounts to “education”

# Education

- **Whether Education necessarily means recognised educational institution alone**
  - Ahmedabad Management Association v Jt DIT(E)28 ITR(Trib) 349 (Ahd)
  - Objects of promoting and development of management in Gujarat, promoting education in the practice of management and related subjects through meetings, discussions, lectures, research projects, seminars, conferences, programmes of studies, etc
  - Conducted over 800 courses and programmes
  - Not a case where assessee is not engaged in activity of instruction of education
  - Also granting diploma – more than 80% of receipts on account of continuing education, diploma and certificate programmes
  - Fulfils test of systematic instruction and training
  - Engaged in activity of education – proviso to s.2(15) not applicable

# S. 12AA Registration

- Whether carrying on of Activity Essential Before Registration
- S.12AA(1)(b) – after satisfying himself about the objects of the trust or institution and the genuineness of its activities, he shall pass an order.....
- Self Employers Service Society v CIT 247 ITR 18 (Ker)
  - Not commenced any activity related to its objects – only given loans to members
  - Generation of income only for members – no evidence as to genuineness of activities
- DIT v Foundation of Ophthalmic and Optometry Research Education Centre 355 ITR 361(Del)
  - Statute did not prescribe a waiting period for a trust to qualify itself for registration
  - Provision did not prohibit or enjoin the CIT from registering a trust solely based on its objects, without any activity, in the case of a newly registered trust
- DIT(E) vs Meenakshi Amma Endowment Trust 50 DTR 243 (Kar)
  - When no activities are undertaken by the newly established trust/ institution, then in such a scenario, the objects of the trust have to be taken into consideration by the CIT for determination of question of registration

# Taxability of Corpus Donations

- Exempt u/s 11(1)(d) – income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust
- S.2(24)(iia) – Voluntary contributions received by a trust .....
- Till AY 1988-89 – Voluntary contributions received by a trust .... , not being contributions made with a specific direction that they shall form part of the corpus of the trust
- In event of loss of exemption, whether corpus donations taxable?
- DIT v Basanti Devi and Chakhan Lal Garg Education Trust – ITA 927/2009 dated 23.9.2009 (Del HC) – SLP admitted by SC
  - AY 2003-04 – Exemption granted later - Capital Receipt and not revenue receipt
  - AY 2002-03 – Similar view taken by ITAT in ITA No 5082/Del/2010 dated 19.1.2011
- ITO v Gaudiya Granth Anuvad Trust 28 ITR (Trib) 161 (Agra) – capital receipt not taxable
- Shri Shankar Bhagawan Estate v ITO 61 ITD 196 (Cal) – AY 1991-92 - position after amendment is similar to position prior to 1973 – corpus donations are not income – reliance on CIT v Trustees of Kasturbai Scindia Commission Trust 189 ITR 5 (Bom)

# Taxability of Corpus Donations

- DIT(E) v Sri Ramakrishna Sewa Ashrama 357 ITR 731 (Kar)
  - Amounts received towards Rural Project Fund
  - The word 'Corpus' is used in the context of the Act. One has to understand the same in the context of a capital, as opposed to an expenditure. It is a capital of an assessee; a capital of an estate; capital of a trust; a capital of an institution. Therefore, if any voluntary contribution is made with a specific direction, it shall be treated as the capital of the trust for carrying on its charitable or religious activities, then, such an income falls under section 11(1)(d) and is not liable to tax. Therefore, it is not necessary that a voluntary contribution should be made with a specific direction to treat it as corpus. If the intention of the donor is to give that money to a trust which they will keep it in trust account in deposit and the income from the same is utilized for carrying on a particular activity, it satisfies the definition part of the corpus. The assessee would be entitled to the benefit of exemptions from payment of tax levied.

# Taxability of Corpus Donations

- DIT(E) v Sri Ramakrishna Sewa Ashrama 357 ITR 731 (Kar)
  - What is relevant is (i) the intention of the donor and (ii) how the recipient-assessee treats the said income. If the intention of the donor is that the amount/donation given is to be treated as capital and the income from that capital has to be utilized for the charitable purposes, then the said voluntary contribution is towards the part of the corpus of the trust. Similarly, if the assessee after receiving the amount, keeps the amount in deposit and only utilises the income from the deposit to carry out the charitable activities, then also the said amount would be a contribution to the corpus of the trust and the nomenclature in which the amount is kept in deposit is of no relevance as long as the contribution received are kept in deposit as capital and only the income from the said capital which is to be utilized for carrying on charitable and religious activities of the institute/corpus of the trust, for which s.11(1)(d) is attracted
  - The law does not require that the said direction should be in writing. In the instant case, those people who have paid amounts by way of donations that include the cheque with a letter with a specific direction, which is in compliance with s.11(1)(d). In case if the contributions are made without cheques, i.e., by cash, and oral direction has been issued to the trust to utilize the said fund for the purpose of treating the leprosy patients and if such amounts are credited to the account meant for it, even then the requirement of s.11(1)(d) is complied with.

# Depreciation

- Whether depreciation allowable on capital expenditure claimed as an application of income for charitable purposes?
- CIT v. Institute of Banking Personnel Selection 264 ITR 110 (Bom)
  - Income of a charitable trust was liable to be computed in normal commercial manner
  - S. 32 would not apply to such depreciation - income was to be computed after providing for allowance for normal depreciation
  - Depreciation was allowable even on those assets whose actual cost had been allowed as a deduction in computing the income of the earlier years
- Lissie Medical Institutions v CIT 76 DTR (Ker) 372
  - In order to reflect the true income that was available for application for charitable purposes, the assessee should write back the depreciation amount in the accounts to form part of the income to be accounted for application for charitable purposes
  - Income available for application for charitable purposes got reduced by the depreciation amount, which was not permissible under s. 11
  - Such notional claim of depreciation became cash surplus available with the assessee, which remained outside the books of account of the trust, unless it was written back

# Depreciation

- Charitable Institutions were generating unaccounted income equal to the depreciation amount claimed on a year-to-year basis, which was nothing but black money
- Followed Escorts Ltd v Union of India 199 ITR 43 (SC)
- CIT v Market Committee, Pipli 330 ITR 16 (P & H)
  - Not a double deduction - income of the assessee being exempt, it was only claiming that depreciation that was required to be reduced from the income for determining the percentage of funds that were to be applied for the charitable purposes
- DIT v Vishwa Jagriti Mission 73 DTR (Del) 195
  - Allowance of depreciation necessary on commercial principles
  - Depreciation was a necessary charge in computing the net income
- A capital expenditure is treated as an application of income for charitable purposes, under the Act, while depreciation is a deduction in computing the income itself, which is available for application for charitable purposes – two different things

# CAG Report

- Registration u/s.12AA – Winding Up Clause
  - Non inclusion of Dissolution clause in trust deed
  - Para 2.7(viii) of Manual of Office Procedure (Vol II) of ITD provides that in case of dissolution of a trust, its net assets ,after meeting all its liabilities, should not revert to its founder, members, directors, donors, etc., but used for its objects. In the absence of dissolution clause, the corpus of trust is susceptible to misuse at the time of dissolution
  - Ministry reply – in Mumbai & Gujarat, Bombay Public Trusts Act, 1950 ensures that no amount can go back to any founder, etc. because properties are transferred with the permission of the Charity Commissioner only to other Trusts having similar objects. Thus, inclusion of dissolution clause in the deed is neither necessary nor legal in States where specific legislation bars such reversion.
  - Audit is of the view that clauses in local legislation applicable to particular states do not cover across the country. Further, procedures prescribed under other acts cannot be enforced under Income Tax Act, which does not specify the fate of assets and properties generated out of public monies by Trusts exempted from tax. The Ministry has not highlighted the no of cases where the Charity Commissioner has taken action to revert the assets to other Trusts having similar objects. Therefore, the Ministry should insist upon inclusion of dissolution clause in the trust deed in all States, whether local legislation exists or not

# CAG Report

- Registration u/s.12AA – Winding Up Clause

- Non inclusion of Dissolution clause in trust deed

- S.14 of Societies Registration Act, 1860

- **Upon a Dissolution No Member to Receive Profit:**

If upon the dissolution of any society registered under this Act there shall remain after the satisfaction of all its debts and liabilities any property whatsoever, the same shall not be paid to or distributed amongst the members of the society or any of them, but shall be given to some other society, to be determined by the votes of not less than three fifths of the members present personally or by proxy at the time of the dissolution, or, in default thereof, by such court as aforesaid.

- Rule 6 - Companies Regulations, 1956 read with clause 10 of Annexure I – compulsory clause

If upon a winding up or dissolution of the company, there remains, after the satisfaction of all the debts and liabilities, any property whatsoever, the same shall not be distributed amongst the members of the company but shall be given or transferred to such other company having objects similar to the objects of this company, to be determined by the members of the company at or before the time of dissolution or in default thereof, by the High Court of Judicature that has or may acquire jurisdiction in the matter.

# CAG Report

- Registration u/s.12AA – Winding Up Clause
  - Non inclusion of Dissolution clause in trust deed
  - Funds can be used only for objects of the trust
  - If funds distributed to trustees, would constitute breach of trust under general trust law – trustees can be sued by beneficiaries/action by Charity Commissioner

# CAG Report

- Incorporation of PAN requirement in Form No 10A
- Development of database of registered trusts to co-ordinate between approving authorities and assessing officers – linkage of PAN, details of registration and assessment
- Evolution of mechanism so that trusts are not allowed accumulations consistently through strict monitoring of Form 10 and amendments to restrict such accumulations
- Control mechanism to ensure utilisation of accumulated funds within time – reporting by auditor not sufficient
- Monitoring of checking of investments made in unauthorised modes
- Withdrawal/cancellation of registration/approvals in cases of violation of s.13

# CAG Report

- Monitoring of accumulations and usage in specified mode, specified time and for specified purposes
- Ensure that all stipulated conditions fulfilled before granting exemption u/s.11(2) – e filing & auto processing of Form 10
- Selection of FC cases for scrutiny as per CBDT guidelines
- Suitable amendments in Act to streamline treatment of depreciation, deficit and repayment of loans
- Verify information of major donations received u/s.80G to ensure proper accounting of donations by donors
- Suitable definition for term "substantially financed"
- Suitable modification in TDS compliance provisions for trusts (allowance of deduction where no TDS deducted) and requirement of proper disclosure in audit reports
- Suitable changes to be made in Forms 10B and Form 10BB – yearwise details of accumulations, donations u/s.115BBC, compliance with TDS provisions

Thank you