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**TAXATION OF CHARITABLE**  
**ORGANISATION UNDER**  
**INCOME TAX ACT**

**CA CHANDRASHEKHAR N. VAZE**

# Entities Covered

- ▶ Trusts registered under Public Trusts Acts (State Laws)
- ▶ Societies registered under Societies Registration Act, 1860
- ▶ Companies registered under Sec. 25 of Companies Act, 1956 (now under section 8 of Companies Act, 2013)

Co-operative Societies are governed by Sec. 80P and principle of mutuality. They are not generally recognised as charitable entities.

# Charitable Purpose - Sec. 2(15)

As per section 2(15), charitable purpose includes –

- (i) relief of the poor,
- (ii) education,
- (iii) Yoga,
- (iv) medical relief,

# Charitable Purpose - Sec. 2(15)

- (v) preservation of environment (including watersheds, forests and wildlife)
- (vi) preservation of monuments or places or objects of artistic or historic interest
- (vii) the advancement of any other object of general public utility.

# Charitable Purpose - Sec. 2(15) – contd...

Proviso to (vii)th limb

Not charitable purpose if activity in the nature of trade, commerce or business is undertaken.

Exception to this proviso,

- ▶ activity is undertaken in the course of actual carrying out such advancement of any other object of general public utility
- ▶ aggregate receipts from this activity do not exceed 20% of total receipts of the trust

# Charitable / Religious Trust

- ➡ Trust should either be wholly charitable or wholly religious
- ➡ Provisions of Section 11 not applicable for partly charitable or partly religious trust

# Private Trust distinct from Public Trust

Based on who is the beneficiary?

- **Public trust** : A public trust is one which benefits the public at large or some considerable portion of it.
  
- A public trust can be of two types,
  - ▶ (a) Public charitable trust,
  - ▶ (b) public religious trust.

# Private Trust distinct from Public Trust

- ▶ **Private trust** : In case of private trust, the beneficiaries are individuals or families. Private trusts are further broadly classified into:
  - ▶ Private specific trust also referred to as Private Non Discretionary Trust where both beneficiaries and shares are determinate.
  - ▶ Private Discretionary Trust where the beneficiaries or their shares or both are indeterminate.



## Distinction between Sec. 10 and Sec. 11

- ▶ for claiming exemption u/s 11, the institution has to first obtain registration u/s Sec. 12AA (now 12AB)
- ▶ to obtain timely registration u/s 12AA (now 12AB)
- ▶ obligation to spend 85% of receipts
- ▶ fresh registration within 30 days in case of modification of objects

# Distinction between Sec. 10 and Sec. 11

- Section 10 is an exemption section which means any income falling under the various sub-sections of section 10 shall not be included in the total income itself.
- Strictly speaking, registration u/s 12AA is not a pre-condition for section 10.
- The requirement of spending 85% of the receipts is mandatory only in certain cases of section 10.

# General Scheme of Taxation

## ➡ Income

- ▶ Voluntary Contributions, donations
- ▶ Property Income
- ▶ Business Income – Sec. 11(4) & 11(4A) – business should be incidental and separate books of account to be maintained
- ▶ Capital Gains – Sec. 11(1A) – whether indexation available?

Contd..

# General Scheme of Taxation

## ➡ Income... Contd..

- ▶ Government grants
- ▶ Income from investments
- ▶ Surplus from activity

# General Scheme of Taxation

## Expenditure

There are three categories –

- ▶ Expenditure for earning the income (Charity Show; Commission for ads etc.)
- ▶ Administrative/establishment expenses
- ▶ Expenditure on objects

40A(3) and 40A(3A) i.e Non deductibility of expenditure otherwise than by account payee cheques shall be applicable even to Trusts w.e.f 01.04.2019 i.e A.Y 2019-20 and 40(a)(ia) (non-deduction of tax at source).

# General Scheme of taxation

## Expenditure on objects – Contd...

Peculiar treatment of Capital expenditure

- a) Depreciation
- b) Repayment of loan
- c) Deficit/Set-off of earlier years
- d) Donation to other trusts (out of current income is treated as “application”; but not out of accumulated income)

# General Scheme of Taxation

Sec. 10(23C)(iiiab), (iiiac) – Educational Institution / Hospital

Meaning of 'wholly or substantially financed.'

Notification No. 79/2014/F.No. 142/12/2014 – TPL – Institution is substantially financed if Government grant exceeds 50% of total receipts.

# Setting aside of Income – 15%

- ➡ Spending required - 85%
- ➡ **As per circular** No. 12-P [LXX-7 of 1968], dated 26-11-1968, if a trust desires to accumulate income in excess of the limits laid down in section 11(1), the conditions specified in section 11(2) have to be fulfilled in respect of the entire accumulation and not merely in respect of the accumulation in excess of 25 per cent of the income.



# Setting aside of income – 15%

- Further, if the trust does not comply with the conditions laid down in section 12(2), the amount which becomes liable to assessment under section 11(3) is the entire income accumulated and not merely the income accumulated in excess of the limits specified in section 11(1). In other words, such an assessee loses benefit of the accumulation permitted under section 11(1).

# Application of income

- ▶ During the previous year
- ▶ During the following year – clause 2 of explanation to Section 11(1) – Earlier a simple letter was sufficient for accumulation of income upto one year. Now, **Finance Bill, 2015 has made it mandatory w.e.f 01.04.2016 to exercise such option by filing Form 9A electronically before the expiry of time allowed for furnishing the return of income u/s 139(1)**

# Application of income

- ➡ During next five years - Accumulation Section 11(2)
- ➡ Form No. 10. – Every year or at one time?  
**Section 11(2) has been amended by the Finance Bill, 2015 w.e.f 01.04.2016 to the effect that Form 10 should also be electronically filed on or before the due date for furnishing return u/s 139(1).**
- ➡ For accumulation, no separate Reserve is required

# Application of income

- ▶ **CBDT has issued Circular No. 7 / 2018 – F.No.197/55/2018-ITA-I authorizing Jurisdictional CITs to condone the delay in case of belated filing of form 9A and 10 for A.Y 2016-17**
- ▶ **The Finance Act, 2017** has brought an amendment to section 11 which states that where any donation made by one charitable trust / institution to another charitable trust / institution with a specific direction that such donation shall form part of the corpus of the donee trust / institution, such donation shall not be treated as application of income.

# Carry forward and set off of excess expenditure for the year

## Case Laws

- ▶ CIT(E) vs Subros Educational Society (2018) 303 CTR 0001 (SC)
- ▶ CIT vs Institution of Banking Personnel Selection (IBPS) (2003) 131 Taxman 386 (Bombay HC)

# Section 115TD

## ➡ Tax on market value of assets – introduced by Finance Act, 2016 w.e.f 01.06.2016

As per this provision, when any of the situations below arises;

- ▶ If the registration of the trust u/s 12AA is cancelled or the trust has adopted modification in the objects which do not conform to the conditions of registration;
- ▶ The trust is merged with an entity not registered u/s 12AA or which has different objects;

# Section 115TD

- ▶ On dissolution, failed to transfer the assets within 12 months from the date of dissolution to any other trust / institution registered u/s 12AA or the trust registered under some of the sub-clauses of section 10(23C), then, **in addition to normal tax**, the trust will be required to pay tax on difference between market value of assets and liabilities at Maximum Marginal Rate (i.e highest tax in case of person which is presently 30%)

# Audit report - Form 10 B / Form 10BB

- ▶ **In case of assesseees covered under sub-clause (iv)/(v)/(vi)/(via)of section 10(23C) – Contd...**
  - ▶ Section 12 A (b)
  - ▶ Tax Audit - 'Receipts' - As per ICAI Guidance Note, receipts of charitable hospital are subject to tax audit.
  - ▶ Return of Income - Section 139 (4A) [Trusts enjoying exemption u/s 10 also are required to file Return of Income- Refer Sec. 139(4C)]



# Audit report - Form 10 B / Form 10BB

## ▶ In case of assessee covered under sub-clause (iv)/(v)/(vi)/(via) of section 10(23C) –

- ▶ to be submitted electronically along with the return.
- ▶ Finance Act, 2017 has also inserted clause (ba) to section 12A(1) w.e.f 01.04.2018 which states that the provisions of section 11 and 12 would be applicable only when the trusts have filed the return on or before the due date.
- ▶ Circular No. 10/2019 dated 22.05.2019 for condonation of delay in filing Form 10B for years prior to A.Y. 2018-19

# Audit report - Form 10 B / Form 10BB

- ▶ In case of assesseees covered under sub-clause (iv)/(v)/(vi)/(via)of section 10(23C) –
  - ▶ Penalty for delay - Section 272A
  - ▶ Assessment - Section 143(3) Proviso –
  - ▶ ICAI has issued Guide to Audit of Public Trusts.

# Tax Deduction at Source

- ➡ TDS Exemption Certificate - Section 197 read with Rule 28AA, 28AB (Application in Form 13 etc.)
- ➡ Trust to deduct tax of others

Finance Bill 2018, has proposed that the provisions of section 40a(ia) i.e disallowance of expenses on account of non-deduction of tax at source

- ▶ Section 80G  
Form 10G  
No deduction to the donor if donation of any sum exceeding Rs. 2000/- is given in cash

- ▶ Section 35 (1) (ii) (Scientific Research organisations)  
Form 3CF

# **Business Income - Section 11(4) and (4A)**

A business undertaking held by a trust will be treated as a property held under a trust. Where a claim is made that the income of any business shall not be included in the total income, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of the Act relating to assessment. Where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

**In the case of a trust, or institution income from business would be eligible for exemption if the following two conditions are fulfilled -**

- ➡ The business carried on should be incidental to the attainment of the objects of the trust / institution.
- ➡ Separate books of account should be maintained in respect of such business.

# Other Conditions

- ➡ Section 11 (5) - Investments
- ➡ Section 13 - Withdrawal of exemption
- ➡ Specified persons – ‘benefit’

## Anonymous donation [Sec. 13(7)]

- ➡ Section 13 has been amended from the assessment year 2007-08 to the effect that any anonymous donation will not be eligible for deduction under sections 11 and 12.

**contd...**



# Anonymous donation [Sec. 13(7)]– contd...

- It is a voluntary contribution referred to in section 2(24)(ia)
- The person receiving such contribution does not maintain a record of -
  - ▶ the identity indicating the name and address of the person making such contribution; and
  - ▶ such other records as may be prescribed

**contd...**

# Anonymous donation [Sec. 13(7)]– contd...

## ➡ **Special Rate of tax [Sec. 115BBC(I)]**

"Anonymous donation" would be taxable at the rate of 30 per cent (+EC) on the aggregate of anonymous donations received in excess of the higher of the following –

- ▶ five per cent of the total donations received by the assessee
- ▶ one lakh rupees

contd...

# Anonymous donation [Sec. 13(7)]–contd...

- ➡ Institutions affected by the above provisions [Sec. 115BBC(1)] - The above provisions are applicable in the case of following –
  - ▶ any trust or institution referred to in section 11
  - ▶ any university or other educational institution referred to in section 10(23C)(iiiad) & (vi)

**contd...**

Institutions affected by the above provisions [Sec. 115BBC(1)] - The above provisions are applicable in the case of following – **contd...**

- ▶ any hospital or other institution referred to in section 10(23C)(iii) and (vii)
- ▶ any fund or institution referred to in section 10(23C)(iv); and
- ▶ any trust or institution referred to in section 10(23C)(v)

# Anonymous donation [Sec. 13(7)]–contd...

## ➤ Donations not affected by the above provisions [SEC. 115BBC(2)]

The following anonymous donations **shall not be covered** by the provisions of section 115BBC –

- ▶ donations received by any trust or institution created or established wholly for religious purposes; and
- ▶ donations received by any trust or institution created or established for both religious as well as charitable purposes with specific direction that such donation is for educational institution – hospital run by that institution

# Some important circulars

- ➡ CBDT instructions 883 dt. 24.09.75
- ➡ Circular 387 dt. 06.07.1984
- ➡ Circular no. 5-P (LXX,6) dt. 19.06.1968
- ➡ Circular no. 100 dt. 24.01.1973
- ➡ Circular No. 395, dated 24th September, 1984

**contd...**

## **Some important circulars – contd...**

- ➡ Circular No.725 dt 16.10.1995
- ➡ Circular No. 580 dt 14.10.1990
- ➡ Circular No. 52 dt 30.12.1970
- ➡ Circular No. 273, dated 3-6-1980

# Some important Case - Laws

## **a. ACIT V Thanthi Trust etc. – 247 ITR 785 - SC**

There is no exemption u/s 11 available to the Trust carrying on the newspapers publication activity unless the business is carried on in the course of actual carrying out of a primary purpose of the trust.

## **b. CIT v/s Palghat Shadi Mahal Trust – 254 ITR 212 - SC**

Trust for backward community eligible for exemption. Muslims in Kerala is notified as a backward community. The trust provides that Muslims all over the world will be eligible for benefit. The exemption u/s 11 will not be available, since Muslims other than those in Kerala are not backward community.



**c. CIT v/s Programme for Community Organisation – 248 ITR 1 – SC**

Accumulation of 25% on 'gross receipts' (and not 25% of net of establishment expenses) Now, it is 15%.

**d. CIT v/s Nagpur Hotel Owners' Association – 247 ITR 201 – SC**

Accumulation of income – Form 10 can be filed upto the date of assessment. This judgment is now overruled due to amendment brought in by the Finance Bill, 2015.

**e. Trustees of N.E.H. The Nizam's Pilgrimage money Trust v CIT – 243 ITR 676 – SC**

Public purpose of charitable or religious nature should be in India. Situs of property held in trust is irrelevant. It may not be in India. Also if property is in India but purpose is outside India, in that case no exemption under Wealth Tax Act is available. For Income Tax purpose, refer Oxford University Press v CIT 115 Taxman 69/247 ITR 658 (SC) 2001.

**f. CIT v/s Hindustan Welfare Trust 206 ITR 138 – Calcutta**

It was held that fixed deposits of 60 days is also a capital asset.

**g. DIT(E) V Shardaben Bhagubhai Mafatlal Public Charitable Trust – 247 ITR 1**

The status of the trust is that of an individual and is eligible for deduction under section 80L. Only for rate purpose, the trust will be treated as AOP.

**h. Shri Plot Swetamber Murti Pujak Jain Mandal 211 ITR 293 – Gujarat**

Adjustment of excess expenditure made in earlier years can be allowed as deduction in computation of income in the subsequent year.

## i. **CIT V Framjee Cawasjee Institute – 109 CTR 463**

Depreciation is also allowed as deduction. However, in view of decision of SC in Escorts Ltd. v/s Union of India – 199 ITR 43 for double deduction, it cannot be presumed that deduction of depreciation will be allowed in addition to the Capital expenditure unless specifically provided by law. This decision was reaffirmed by the Bombay High Court in the case of **CIT V Institute of Banking 264 ITR 110.**

### **Note:**

The Finance Act, 2014 has inserted sub-section (6) to section 11 to the effect that where purchase of a capital asset has been claimed as application of income in any previous years, the deduction of depreciation on the same capital asset shall not be allowed as application u/s 11.

**j. St. Anes - 17 TTJ 185 Bangalore**

Agnel Charitable Trust 27 ITD 545 Delhi

ITO vs Satya Kabir 50 TTJ 501 Ahmedabad

Utilisation of building fund – amount not remaining intact  
- whether character of corpus lost? – No.

**k. Addl. CIT v/s Surat Art Silk Cloth Manufacturers Association – 121 ITR 1 (SC)**

The mere fact that activities of the trust yield profit, will not alter the charitable character.

**l. Birla Janahit Trust (Cal.) 208 ITR 372**

Establishment expenditure is also an expenditure on objects.

**m. DIT v Malad Jain Yuvak Mandal Medical Relief Centre (Bom.) ITA No.186 of 2000 dt. 30.03.2001 – BCAS May 2001 page 168 –**

Submission of Return is mandatory even if the income is exempt u/s 10.

**n. CIT V Jayashree Charity Trust (1986)159 ITR 280 (Cal) –**

Deemed Income (Tax deducted at source) must be excluded in computing the income.

**o. SRMMCTM Tiruppani Trust v CIT (1998) 96 Taxmann 635 (SC) –**

If after filing Form no.10 for accumulation of income, assessee without investing income in Government securities applied the same for charitable purposes, exemption could not be denied on the ground that conditions of section 11 (2) (b) were not complied with.

**p. Bhagwad Swarup Shri Shri Devraha Baba Memorial Shri Hari Parmarth Dham Trust –**

In a case where the Commissioner of Income Tax does not pass the order granting or refusing registration of Trust within the period laid down in sec.12AA(2) registration would be deemed to have been granted to the Trust or Institution automatically on expiry of the period specified in Section 12AA(2) of the Act.



**q. Disha India Micro Credits vs. CIT (ITAT Delhi)**

Activity of giving micro-finance & earning interest is “charitable purpose”.

**r. ACIT vs. The Upper India Chamber of Commerce (ITAT Lucknow) (ITA No.601/LKW/2011)**

S. 50C vs. s. 11: If a charitable institution invests the entire sale consideration in other capital asset, s. 50C should not be invoked.

The All the forms which are to be filed with Income Tax Authorities will henceforth be submitted on-line.

# ISSUES

- ➡ Would collecting of donations at the time of admission of students by an educational Institution amount to carrying out an activity for profit?
- ➡ Is an administering body that runs colleges and hospitals entitled to exemption u/s 10(23C)?
- ➡ Do specific directions have to be in writing for donations/contributions to enjoy exemption u/s 11(1)(d)?

## ISSUES – contd...

- What is “Corpus”? Can funds collected as corpus donation be spent?
- Is expenditure on administration of a trust treated as expenditure on objects of the Trust?
- If the expenditure on objects results in a deficit, can it be set off in the succeeding years?

## ISSUES – contd...

- Is an accumulation application required to be filed each year or is it possible to file a single application for the succeeding five years?
- When can an accumulation application be filed? Is it necessary to file it along with the return of income?
- Can a Section 25 Company be registered U/s 12AA?

## ISSUES – contd...

- A trust enjoying exemption U/s 10(23C)(iiiad) renders educational services to the son of the Trustee charging the same fees applicable to other students? What will be the consequences?
- A Trust carried on a business, which is unrelated to the objects of the Trust. The surplus is utilised only on objects of the Trust, and no other benefit is derived by the Trustees. What are the tax implications?

# ISSUES – contd...

- While a charitable or religious trust running educational or medical institution or a hospital is allowed to enjoy the exemption even after providing free or concessional services to certain specified persons, any other trust or institution other than this is denied exemption merely because only some part of its income or property is used or applied for the benefit of certain specified persons. Is such anomaly in law fair?
- In a particular year, when the expenses incurred are exceeding the receipts, whether the Trust would be entitled to carry it forward for subsequent year or not?

# AUDIT UNDER INCOME TAX ACT, 1961 (I.T.ACT)

- ➡ In addition to the points taken up in the main paper it is also worthwhile to know about the audit of trusts under the Income Tax Act.
- ➡ Sec. 12A(b) of the IT Act states that where the total income of the Trust as computed under the Act without giving effect to the provisions of Sec. 11 and Sec. 12 exceeds the maximum amount not chargeable to tax in any year, the accounts of the Trust for the year must be audited by a Chartered Accountant. This report is to be given in Form no.10B.

# AUDIT UNDER INCOME TAX ACT, 1961

## (I.T.ACT) – contd...

The first part of Form 10B contains a certificate regarding maintenance of proper books and records; and whether the accounts show a true and fair position. The second part requires him to state the year's surplus, accumulation of income, utilisation of income (application); and whether any income or property was used for the benefit of specified (excluded categories) persons.



# AUDIT UNDER INCOME TAX ACT, 1961 (I.T.ACT) – contd...

- ➡ The ICAI has issued a 'Guide to Audit of Public Trusts under Section 12A'. The Auditor has only to reasonably verify the details stated in second part of Form 10B without expressing any opinion thereon. The list of excluded persons is often so large that it is not practicable to ascertain full compliance [Refer Sec.13 particularly Sub-sec. (3) of Income Tax Act.]

**The report in Form 10B is to be furnished electronically alongwith the return**

# AUDIT UNDER INCOME TAX ACT, 1961 (I.T.ACT) – contd...

- It is possible to have the accounts audited by one auditor and to get report in Form 10B from another auditor.
- The 'Guide' issued by ICAI also makes a few important points, viz.
  - ▶ Sec.44AA of IT Act does not directly apply to Trusts. (Maintenance of accounts).
  - ▶ Part I of 10B is a 'report' while Part II is merely the particulars to be set-forth'.

# AUDIT UNDER INCOME TAX ACT, 1961 (I.T.ACT) – contd...

- ▶ Accounts should be prepared in accordance with the generally accepted accounting principles such as distinction between capital and revenue. The trust may charge capital expenditure to Income & Expenditure Account in terms of conditions of certain grants. However, it must be shown in the Balance Sheet;

# AUDIT UNDER INCOME TAX ACT, 1961

## (I.T.ACT) – contd...

- ▶ Auditor's duties relates to his Audit Report (Part I) primarily; whereas it is only secondary in respect of Part II. For the latter, it extends only to a reasonable verification. Hence, the Auditor's role in regard to Part II is limited.
- ▶ It is advisable to obtain a certificate from the trustees as to the list of persons referred to in Sec.13(3) and a declaration regarding the income or property applied for the benefit of such persons. Certain details in Part II may not be verifiable. Hence, the Auditor should indicate the limitations clearly by stating as follows -

# AUDIT UNDER INCOME TAX ACT, 1961 (I.T.ACT) – contd...

“The annexure has been prepared by the trustees of the Trust who have certified the persons covered by the provisions of section 13(3). The particulars in the annexure have been broadly verified by the undersigned in the light of the aforesaid certificate, as also the information and explanations given by the Trustees.”

# AUDIT UNDER INCOME TAX ACT, 1961 (I.T.ACT) – contd...

In some cases, the Trustees themselves may not be able to certify the exact list of persons under section 13(3). The auditor will then have to qualify “The Trustees of the Trust have not been able to ascertain as to who are the persons covered by section 13(3). In the absence of such ascertainment, it is not possible to give information against the items specified”.

(For a detailed discussion, refer BCAS publication – ‘Taxation of Charitable Trusts’ June 2001, Chapter 12.)

# AUDIT UNDER INCOME TAX ACT, 1961

## (I.T.ACT) – contd...

- ▶ There is a dilemma as to whether the tax audit u/s 44AB is applicable to the Charitable Trust whose gross receipts exceed the prescribed limits. Strictly speaking, Sec. 44AB is essentially in the context of business or professional income. Therefore, Sec. 44AB will apply only if the Trust is carrying on business or profession whose gross receipts or turnover exceeds the prescribed limits.
- ▶ ICAI, however, has expressed a contrary view in the publication `Issues on Tax Audit'. The requirement as to the publication of accounts of certain large trusts which was inserted by the Finance Act, 2001 was rightly omitted by Finance Act, 2002.

# AUDIT UNDER INCOME TAX ACT, 1961

## (I.T.ACT) – contd...

- ▶ Sec. 145 as to the Method of Accounting (cash or accrual) also applies to Trusts. In case cash basis is followed, the ICAI has recommended the incorporation of the following two paragraphs as a part of the audit report.

“It is the policy of the enterprise to prepare its financial statements on the cash receipts and disbursements basis. On this basis revenue and the related assets are recognised when received rather than when earned, and expenses are recognised when paid rather than when the obligation is incurred.”



# AUDIT UNDER INCOME TAX ACT, 1961 (I.T.ACT) – contd...

“In our opinion, the financial statements give a true and fair view of the assets and liabilities arising from cash transactions of \_\_\_\_\_ at \_\_\_\_\_ and of the revenue collected and expenses paid during the year then ended on the cash receipts and disbursements basis”.

Refer Notification issued by the ICAI in January 1994.

# AMENDMENTS MADE BY FINANCE ACT 2020

- Fresh registration required u/s 12AB instead of 12AA w.e.f 01.10.2020. Further, this registration to be renewed every 5 years. Trust registered u/s 12AA will automatically get 12AB on application.
- Similar amendments are there in sec.80G w.e.f 01.10.2020 (fresh certificate & renewal every 5 years)
- List of donors to be uploaded by the trust to enable the donors to claim deduction u/s 80G.

# **MOST IMPORTANT!**

Exemption may now be lost if any of the compliances is delayed beyond prescribed time such as

- Filing of return
- Filing of form 9A
- Filing of form 10
- Filing of audit report- form 10B/10BB
- And so on...

THANK YOU