

Taxation of Charitable Trust-Amendments Proposed in the Finance (No.2) Bill 2014



Charitable Trusts have always been a hotspot in the domain of Direct Taxation considering the separate scheme of Taxation and Exemptions provided to them under Chapter III of the Income-tax Act, 1961 (hereinafter referred to as the "Act") and the relevant rules thereunder. Charitable Trusts of late have garnered even more importance with the much discussed Intelligence Bureau's report on NGOs and their sources of funding and the Income Tax proceedings in the much publicised National Herald Scam involving the political big wigs of our country. In this article however, the focus would be restricted to getting the readers acquainted with key changes w.r.t. taxation of Charitable Trusts in the Finance (No.2) Bill, 2014 (hereinafter referred to as "the Bill") proposed by the Government.

A. Key Amendments

1. Non applicability of Other Exemptions under 10 to Charitable Trusts

The existing provisions of Section 11 of the Act provide for exemption to trusts in respect of income derived from property held under trust and voluntary contributions subject to prescribed conditions. The primary condition for grant of exemption is that the income derived from property held under trust should be applied for the charitable purposes/accumulated and later applied for charitable purpose.

Section 13 of the Act provides for the circumstances under which exemption under Section 11 or 12 would not be available to a trust



CA. G. Sekar

(The author is a member of the Institute. He can be reached at sekarg.gurukripa@gmail.com)

or institution. The Sections 11, 12, 12A, 12AA and 13 constitute a complete code governing the grant or withdrawal of registration and its cancellation, providing exemption to income, and also the conditions to be satisfied by a Charitable Trust

Several issues have arisen in the applicability of the general provision of exemptions which are contained in Section 10 of the Act in the context of the specific exemption under Sections 11 to 13.

Following the decision in the case of *Bar Council of Maharashtra* [130 ITR 28], there have been several instances where the registered trusts claiming benefits under Section 11 do not apply their income, for charitable purposes. In such instances, where the income is taxable, a claim of exemption under general provisions of Section 10 would be contrary to the specific provisions under Sections 11 to 13

Therefore, it is proposed to amend Section 11 to include a new sub-Section (7) as follows—

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

Therefore, that where a trust is availing exemption under section 11, and the registration is in force for a previous year, then such trust or institution cannot claim any exemption under any provision of Section 10 [other than that relating to exemption of agricultural income and income exempt under Section 10(23C)].

Similarly, entities which have been approved or notified for claiming benefit of exemption under Section 10(23C) would not be entitled to claim any benefit of exemption under other provisions of Section 10 (except the exemption in respect of agricultural income).

2. Disallowance of Depreciation where Cost of Asset has already been allowed

The existing provisions of Section 11/10(23C) inherently provide that when income is applied to acquire a capital asset the same can be treated as application of income. Further, depreciation on

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the said asset can also be claimed by the assessee as provided in the below cases—

- *Institute of Banking Personnel Selection 131 Taxmann 386 (Bom.)*
- *CIT vs. Munisuvrat Jain 1994 Tax Law Reporter 108*
- *Framjee Cawasjee Institute [1993] 109 CTR 463 (Bom.)*

It was also held by the High Court of Punjab & Haryana in the case of *Commissioner of Income-tax vs. Market Committee, Pipli*, that claim of depreciation by a charitable institution, whose income is fully exempt, does not amount to taking of double benefit by such charitable institution. The income of the assessee being exempt as the assessee was merely claiming depreciation as a deduction for calculating the amount applied for charitable purpose.

To counter the above decisions, it is proposed to amend Section 11 and 10(23C) by inserting the following provision—

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

By virtue of the above provision, w.e.f. 01-04-2015 providing depreciation shall not be allowed in respect of any asset, the cost of acquisition of which has been claimed as an application of income in the same or any other previous year.

3. Definition of the term "Substantially financed by Government" under Section 10(23C)

Presently, the Act provides for exemption in respect of the income of certain educational institutions, universities and hospitals which are wholly or

"Substantially financed by the Government." The term substantially financed by the Government had not been defined in the Act, leading to a lot of litigation.

W.e.f. 01-04-2015, the meaning of the term "wholly or substantially financed by the Government" has been clarified to cover cases where the Government grants to such university or other educational institution, hospital or other institution, exceeds a specified percentage (to be prescribed) of its total receipts (including any voluntary contributions), during the relevant financial year.

4. Cancellation of registration of the trust or institution in certain cases

The existing provisions of Section 12AA (and under Section 10(23C)) of the Act provide that the registration once granted to a trust or institution shall remain in force till it is cancelled by the Commissioner. The Commissioner can cancel the registration under two circumstances -

- (a) The activities of a trust or institution are not genuine, or;
- (b) The activities are not being carried out in accordance with the objects of the trust or institution.

Therefore, the powers of Commissioner to cancel registration were considered limited in nature.

The Commissioner did not have explicit powers to cancel registration in cases where trusts, particularly in the year in which they have substantial income claimed to be exempt under other provisions of the Act, or have violated provisions of Section 13 by investing in prohibited mode or where the income has been diverted for benefit of certain Prohibited persons under Section 13(3).

Thus, the powers of the Commissioner to cancel registration under Section 12AA have been widened

It is proposed that no action for reopening of an assessment under Section 147 shall be taken by the Assessing Officer in the case of such trust or institution for any assessment year preceding the first assessment year for which the registration applies, merely for the reason that such trust or institution has not obtained the registration under Section 12AA for the said assessment year.

w.e.f 01-10-2014 to provide that where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that—

- It is for benefit of any particular religious community or caste (in case it is established after commencement of the Act);
- Any income or property of the trust is applied for benefit of prohibited persons under Section 13(3)
- Its funds are invested in prohibited modes, then the Principal Commissioner or the Commissioner may cancel the registration if such trust or institution does not prove that there was a reasonable cause for the activities to be carried out in the above manner.

5. Retrospective Exemption

Prior to 01-06-2007 there existed a *proviso* to Clause (a) of Section 12A of the Act, which provided that in case belated application for registration by the Charitable Trust, if the Commissioner is satisfied that the assessee was prevented by sufficient cause from submitting the application within the time limit, then the Exemption under Sections 11 and 12 shall be made applicable from the date of creation of the trust.

However, the above discretionary power of the Commissioner to provide retrospective Exemption was removed by the Finance Act, 2007 w.e.f 01-06-2007. The removal of such discretionary powers resulted in denial of exemption to Charitable Trusts who were unable to obtain registration within the time limit even due to genuine reasons.

Hence, it has also been proposed to tax exemption even for prior years provided the objects or activities of trusts or institutions in those years is same as those on the basis of which registration has been granted.

Further, it is proposed that no action for reopening of an assessment under Section 147 shall be taken by the Assessing Officer in the case of such trust or institution for any assessment year preceding the first assessment year for which the registration applies, merely for the reason that such trust or institution has not obtained the registration under Section 12AA for the said assessment year.

However, the above benefit would not be available in case of any trust or institution which at any time had applied for registration and the same was refused under Section 12AA or a registration once granted was cancelled.

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6. Anonymous Donations under Section 115BBC

Under Section 115BBC anonymous donations received by the following persons are taxable at the rate of 30% -

- Any university or educational institution
- Hospital/Institution
- Fund/Institution
- Trust/Institution

However, the amount of aggregate anonymous donations exceeding 5% of the total donations received by the assessee or ₹1 lakh, whichever is higher shall alone be taxable at 30%.

The current provisions of Section 115BBC, also provide that total income after reducing the full amount of anonymous donations will be chargeable to tax at applicable rates. There is an obvious anomaly in the wordings of the Section and the proper way of computation is to reduce the income by the amount that has been taxed at the rate of 30%.

Therefore, it is proposed to amend Section 115BBC w.e.f 01-14-2015, to provide that the income tax payable shall be the aggregate of the amount of income tax calculated at the rate of 30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or ₹1 lakh, whichever is higher, and the amount of income tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations which is in excess of the 5% of the total donations received by the assessee or ₹1 lakh, whichever is higher.

Illustration

XYZ Educational Trust, a Public Charitable Trust with the following details -

Particulars	₹
1. Income from Property held under trust	75,00,000
2. Total donations (including anonymous donations of ₹10 lakhs)	25,00,000

The below would be the method of computation of taxable income and tax payable for the Previous Years 2013-14 and Previous Years 2014-15 -

A. Calculation of Income to be applied for Charitable Purposes

Particulars	PY 13-14	PY 14-15
1. Income from Property held under trust	75,00,000	75,00,000

Particulars	PY 13-14	PY 14-15
2. Donations (other than anonymous donations of ₹10 lakh)	15,00,000	15,00,000
3. Less: Amount as per Sch B Below	(10,00,000)	(8,75,000)
	Sch B(1)	Sch B(3)
4. Income to be applied for Charitable Purpose (See Note*)	80,00,000	81,25,000

B. Anonymous Donations Taxable at 30%

Particulars	PY 13-14	PY 14-15
1. Anonymous Donations	10,00,000	10,00,000
2. Less: Non Taxable Anonymous Donations—Higher of—[5% of Total Donations 25,00,000=1,25,000] or [₹1,00,000]	(1,25,000)	(1,25,000)
3. Taxable Anonymous Donations—Taxable at 30%	8,75,000	8,75,000

*Note: The Effect of the above calculations is that earlier where the amount of ₹1,25,000 was considered as an "Exempt Donation," now the same would be added to the Income which is to be applied for charitable purpose.

Conclusion

It has been hardly 50 days since the Modi Team had been given a verdict to lead this country for next five years. The expectations of the common man, the business community, non-residents, FII's, Markets and all Stake Holders are very high. In spite of the above constraints, most of the proposals outlined in the budget particularly those w.r.t. Charitable Trusts have been made after effectively considering the needs of the ordinary man and the relevant business and non-business sectors of the country. It should also be a source of pride to the Institute also that for the first time probably most of the proposals outlined in the pre-budget memorandum of the Institute have been effectively considered in framing the proposals. Hence, I am able to solemnly conclude that after a long time we have a Government at the centre, which actually listens to its people. May be not immediately, but surely—

"Ache din aane waale hain". ■