

Capital Gains - Whether Income Derived from Property Held under Trust Eligible for Exemption u/s 11(1)(a) of the IT Act



Section 11 of the Income-tax Act is a very important provision from the point of view of charitable and religious organisations. It deals with taxation of income derived from property held for charitable or religious purposes. In the present article, the author has deliberated upon the said section in detail by analysing the sub-sections and relying upon various circulars issued in this regard as well as decisions by the courts of law. Read on to know more...



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- I. Under Section 11 of the Income-tax Act, income derived from property held under trust wholly for charitable or religious purposes is exempt from Income Tax as follows:
Section 11(1) states that subject to the provisions of Sections 60 to 63, the following income shall not be included in the total income of the

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Where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes

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previous year of the person in receipt of the income:

- (a) Income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India and where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of (*fifteen per cent*) of the income from such property,
 - (b) Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.
- II. As given u/s 11(I)(a), 85% of the income has to be applied for charitable or religious purposes failing which the short fall will be subject to income tax. In such a case, there are deeming provisions in the Act to avoid tax liability as given below:
- (a) As given under explanation 2 to Section 11(1), exercise an option (to apply the income in the immediately succeeding previous year) in writing before the expiry of time allowed under sub-section (1) of Section 139 for furnishing the return of income which will be deemed to be income applied to such purposes during the previous year in which the income was derived.
 - (b) Sec 11(1A)- For the purposes of sub-section (1):
Where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then the capital gain arising

from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:

- (I) where the whole of the net consideration is utilised in acquiring the new capital asset the whole of such capital gain;
 - (II) Where only a part of the net consideration is utilised for acquiring the new capital assets, so much of such capital gain as is equal to the amount, if any, by which the amount so utilised exceeds the cost of the transferred asset.
- (c) Under Section 11(2) where (eighty-five per cent) of the income referred to in clause (a) of sub-Section (1) read with the explanation to that sub-Section is not applied, or is not deemed to have been applied, to charitable or religious purposes in India during the previous year but is accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person in receipt of the income, provided the following conditions are complied with, namely:
- (I) Such person specifies, by notice in writing given to the (Assessing) Officer in the prescribed manner, the purposes for which the income is being accumulated or set apart and the period for which the income is to be accumulated or set apart, which shall in no case exceed five years:
 - (II) The money so accumulated or set apart is invested or deposited in the terms or modes specified in sub-section (5) of Section 11.
The above provisions make it possible to avail the exemption without applying the income during the year of receipt itself.

III. Definition of income:

As per Section 2(24), "Income" includes I) profits and gains II) dividend III) voluntary contribution received by a trust created for charitable or

religious purposes IV) capital gains chargeable under Section 45 etc.

All such items of income are income derived from property held under trust for charitable or religious purposes for the purposes of Section 11(1).

- IV. Capital gain was considered as a species of income eligible for exemption u/s 11(1) (a) necessitating application of income for religious or charitable purposes in the year of receipt itself resulting in depletion of corpus of the trust. To remedy this drawback, Circular No. 2P dated 15-5-1963 was issued to grant exemption for fund invested in specified securities.

Vide Circular No. 52 dated 30-12-1970 acquisition of a capital asset out of capital gains would amount to application so as to avoid liability.

Paras 73, 75, 76 of Circular No. 72 dated 6-1-1972 explain the objective of placing administrative instruction on a legal footing and are as under:

73. Under section 11 of the Income-tax Act, income derived from property held under trust for charitable or religious purposes is exempt from income-tax to the extent such income is actually applied to such purposes during the previous year itself or within three months next following. As "income" includes "capital gains", a charitable or religious trust would forfeit exemption from income-tax in respect of its income by way of capital gains unless such income is also applied to the purposes of the trust during the stipulated period. In some cases, charitable or religious trusts are required to sell, in the interest of the trust, capital assets forming part of the corpus of the trust property solely with a view to acquiring other capital assets to be held as part of the corpus of trust. The requirement that the capital gains arising from such transactions

should be utilised for charitable or religious purposes, during the accounting year itself or within three months immediately following, has the unintended effect of progressively reducing the corpus of the trust and the income yielded by it.

75. The question of eliminating the disadvantage to charitable or religious trusts in being obliged to spend away the capital gains arising from the transfer of assets constituting the corpus of the trust instead of adding to the corpus, was considered by Government in 1963 and administrative instructions were issued to the effect that where a charitable or religious trust transferred a capital asset forming part of the corpus of its property solely with a view to acquiring another capital asset for the use and benefit of the trust and utilised the capital gains arising from the transaction in acquiring a new capital asset, the amount of capital gains so utilised should be regarded as having been applied to the charitable or religious purposes of the trust. These instructions have recently been reiterated.

76. With a view to placing the aforesaid administrative instructions on a legal footing and removing the disadvantage to charitable and religious trusts for the past as also the future, Section 11 has been amended by Section 5 of the Finance (No. 2) Act, 1971 by way of insertion of a new sub-section (1A). Under the new sub-section, it has been provided that in a case where a capital asset being property held under trust for charitable or religious purposes is transferred and the whole or any part of the net consideration for the transfer (i.e., full value of the consideration as reduced by the expenditure incurred wholly and exclusively in connection with the transfer) is utilised for acquiring another capital asset to be held as part of the corpus of the trust, the capital gain arising from the transfer will be regarded as having been applied to charitable or religious purposes.

The requirement that the capital gains arising from such transactions should be utilised for charitable or religious purposes, during the accounting year itself or within three months immediately following, has the unintended effect of progressively reducing the corpus of the trust and the income yielded by it.

- V. Thus, it can be seen that Section 11(1A) is a deeming provision where capital gains (whole of the net consideration or a part of the net consideration) utilised for acquisition of a capital asset being regarded as having been



applied to charitable or religious purposes u/s 11(1).

By Finance Act 1971, a new provision u/s 11(1A) was introduced with retrospective effect from 1-4-1962 to grant exemption for capital gains invested in a new capital asset. That means now a trust can either apply the capital gains in the year itself for the object of the trust u/s 11(1)(a) or invest in another capital asset u/s 11(1A), including a bank deposit for six months as given in Instruction No.883 dated 24.9.1975 (1994) 206 ITR 138(Cal). It is an option and privilege conferred on charitable trust in respect of application of capital gains.

Originally, exemption was granted only if the capital gain was applied in the year of receipt resulting in the depletion of the corpus. Section 11(1A) enlarged the benefit of exemption enabling the charitable trust to invest in capital asset avoiding depletion of corpus. Capital gain being a species of income derived from property held under trust wholly for charitable or religious purposes exemption will be available for such income if applied u/s 11(1)(a) in the year of receipt.

VI. Refer to the case of *Guruprashad Trust (regd) vs. Deputy Commissioner of Income Tax-93TTJ Chd 1103*.

Issue No.1) AO disallowed a sum of ₹27,270/- having been spent by the trust on construction of boundary wall of the Trust property. CIT (A) confirmed the addition.

One of the objects of the trust was the management and maintenance of the Holy Darbar including addition and alteration of the building and other immovable

property attached to the said Holy Darbar. Held that the assessee is entitled to exemption.

Issue No. 2) The second issue raised by the department was against exemption granted to trust where the sale proceeds of the capital asset was utilised for the purposes for which the trust was created.

The assessee had sold land for ₹22,58,000/- which had a book value of ₹9,600/- only.

The assessee treated the sale consideration minus the cost i.e. ₹22,48,395/- as income of the trust. Exemption was claimed in respect of the amount spent for the objects of the trust out of the said income.

The AO denied the exemption on the ground that capital gain derived from the land was eligible for exemption only under Section 11(1A) which provides for exemption of capital gains in case the trust purchases another property or deposits the amount in fixed deposit or uses for the purpose of the trust within stipulated period.

The CIT (A) held that Section 11(1A) was incorporated to enlarge the benefit available to charitable trusts.

The CIT (A) held that the assessee is entitled to exemption u/s 11 in respect of the sale proceeds of capital asset if utilised for the objects of the trust. The CIT (A) also considered the expenses of ₹12,08,419/- for various purposes to have been incurred for the objects of the trust and directed the AO to allow exemption u/s 11(1).

The revenue is aggrieved. The learned departmental representative contended that Section 11(1A) has been specifically incorporated and if the conditions therein are not satisfied, the assessee is not entitled to exemption in respect of the capital gains derived on sale of immovable property.

The learned counsel for assessee, on the other hand, relied upon the order of the CIT (A). It was contended that Section 11(1A) was incorporated for enlarging the benefit of exemption, so as to enable the charitable trust to purchase capital asset in lieu of capital gains derived from the sale of trust property. The CIT (A) was, therefore, justified in allowing the relief to the assessee, it was contended.

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The Finance (No. 2) Act, 1971, incorporated Section 11(1A) with retrospective effect from 1st April, 1962. The said section provides that if the capital gain arises to a trust and such gain is invested in the purchase of another capital asset, then such investment would be deemed to have been applied for charitable purposes.

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We have given our careful consideration to the rival contentions and have also perused the records including the decision of the AO as well as that of the CIT (A). On perusal of the records, following facts are established:

- (i) That the assessee is a public trust since its inception in the year 1950.
- (ii) That the trust has always enjoyed exemption under Section 11 of the IT Act, 1961.
- (iii) That as a result of sale of immovable property, the income of the trust for the previous year was ₹24,09,370/-.
- (iv) That as per provisions of Section 11 of IT Act, 1961, the income of the charitable trust is exempt to the extent the income is applied for the objects of the trust. The Act also provides for accumulation of income upto the specified limits which also enjoys exemption under Section 11. It is a well-settled principle of law that if the trust does not apply its income for charitable purposes, it loses its exemption to the extent of such income. The definition of income under the provisions of IT Act includes capital gains. If a charitable trust derives capital gains on sale of immovable property, it is required to apply 75 per cent of the income for charitable purposes within stipulated period. The acquisition of immovable property in most of the charitable trusts would not amount to application of income for the objects of the trust. Keeping the above hardships in view, the Finance (No. 2) Act, 1971, incorporated Section 11(1A) with retrospective effect from 1st April, 1962. The said section provides that if the capital gain arises to a trust and such gain is invested in the purchase of another capital asset, then such investment would be deemed to have been applied for charitable purposes.

- (v) In the present case, the assessee had not claimed the benefit of Section 11(1A). The capital gains derived by the assessee had been utilised for the objects of the trust. The major item of expenditure is donation of ₹10 lakh to Shree Gurudwara Trust, Ludhiana. The CIT(A) has treated the donation as application of income for charitable purposes. This view is supported by the following decisions:

- (i) *CIT vs. Sarladevi Sarabhai Trust (1988) 172 ITR 698 (Guj);*
- (ii) *CIT vs. Trustees of the Jadi Trust (1982) 133 ITR 494 (Bom);*
- (iii) *CIT vs. Hindustan Charity Trust (1983) 139 ITR 913 (Cal);* and
- (iv) *CIT vs. J.K. Charitable Trust (1992) 196 ITR 31 (All).*

The other expenses were incurred on the maintenance of trust property attached to Holy Darbar. Since it is not disputed that the buildings for the maintenance of which expenditure has been incurred by the assessee are attached to the said Holy Darbar and the same are being utilised for charitable purposes, the CIT(A), in our view, was justified in allowing the benefit of the exemption for such expenses as having been applied for the objects of the trust.

Finding no infirmity in the order of the CIT(A), we decline to interfere.

In the result, whereas the appeal of the assessee is allowed, the appeal of the Revenue is hereby dismissed.

Thus it can be concluded that there is no distinction between capital gains and other species of income like voluntary contribution, income from house property, income from other sources etc. in the matter of application under Section 11(1) of the IT Act. But in the case of capital gain where 85% cannot be applied, the deeming provision of investment u/s 11(1A) can be applied to avail exemption u/s 11(1) (a) and avoid depletion of corpus as given in Circular No. 72 date 6-1-1972. It is an extra benefit available to the trust in the case of capital gains and what cannot be applied as per Section 11(1A) will become normal income to be applied u/s 11(1)(a) or other deeming provisions of Section 11. ■