Section 115 TD of the Income Tax Act, 1961 related to Trusts and Institutions: a Case for Reconsideration

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Those of the provisions of the Income Tax Act, 1961 (the Act) are discussed and debated widely which, by and large, are of immediate application across the various sections of assessees. Relatively, therefore, the provisions of infrequent application related to specific class of assessees are likely to remain outside the attention of readers although their ramification is large, when applied.

Section 115 TD of the Act inserted by the Finance Act, 2016 w.e.f. 1st June 2016 is one such section which makes a provision of far reaching consequences when confronted with a typical situation elaborated by the section, for public trusts and institutions. Read on …

Brief Framework of Trust Assessment

It is of common knowledge that public trusts and institutions, (hereafter referred to as 'trusts' for the sake of brevity) are afforded a privileged tax treatment under the Act when recognised as such under section 12 AA of the Act, on the basis of genuineness of their activities and certain other compliances visualised for them. Section 12A provides conditions for being eligible to claim exemption under sections 11 and 12 of the Act.

Section 11 of the Act elaborates a comprehensive package of concessional tax treatment to a trust, the crux of which lies in a requirement that the trust spends at least 85% of its income wholly on charitable or religious purposes. There is further relaxation in specified circumstances when accumulation going beyond 15% is spent later in the manner specified.

Section 11 takes care of a situation where the trust spends income for purposes which are not charitable or religious or when the accumulation of income is not utilised for the purposes for which it is accumulated or set apart or when the funds of the trust do not remain

invested or deposited in the manner specified in Section 11(5) of the Act or when the trust appropriates its income to another trust registered under section 12AA or to an institution referred to in certain clauses of Section 10 (23C) of the Act. In this situation, the preferential tax treatment is denied to a trust subject to certain small departures. A preferential tax treatment is also denied where the income is on account of private religious purpose which does not ensure for the benefit of the public or when the trust created after the commencement of the Act, is for the benefit of any particular religious community or caste.

A wide range of situations and circumstances is spelt out is Section 13 of the Act which ensures that the benefits of the trust or its income are not directly or indirectly meant for those who are associated with the formation or management of a trust or otherwise have a relation with it because of their monetary contribution.

The result of denial of application of Sections 11 and 12 of the Act to an erring or non complying trust has been that all its income is taxed normally without giving an allowance for expenses incurred for charitable or religious purposes, in the absence of recognition by the Commissioner of Income Tax under section 12AA of the Act.

What is new?

Section 115 TD introduced by the Finance Act, 2016 has a punitive dimension going much beyond the mere withdrawal of special status under section 12AA, facilitating the benefits under sections 11 and 12 of the Act.

Section 115 TD provides for an additional tax on the 'accreted income' as defined in the section–

- when registration granted to a trust under section 12AA has been cancelled in terms of Section 12 AA (3) or (4) or
- when a trust has modified its objects which do not conform to the conditions of registration and it has not applied for fresh registration under section 12 AA in the related previous year or when the said application has been rejected. In this case, even a formal cancellation of registration does not appear necessary.

In a situation like above, the trust shall be deemed under section 115 TD, to have converted into a form not eligible for registration under section 12AA, and tax on 'accreted income' would be leviable immediately. Such was not the case prior to 01.06.2016 and the refusal or cancellation of registration under section 12AA was alone considered as a sufficient detriment.

The question arises as to what is the quantum of 'accreted income' on which additional tax would be leviable and the answer is this -

'The accreted income' means the amount by which the aggregate fair market value of the total assets of the trust as on the date of 'conversion', i.e., the date of default, exceeds the total liability of such trust in the Balance Sheet. In tune with the norms prescribed for valuation of net assets, shares and securities, when quoted, would be valued at their fair market value and when unquoted, the Rule 17 CB prescribes a formula for determination of fair market value.

The fair market value of immovable property shall be higher of the value certified by a registered valuer and stamp duty value on the date of default.

The fair market value of business undertaking held by a trust shall be on the basis of fair market value of the net assets of the trust.

In short, in every case of an asset, the basis of valuation is Fair Market Value and not the Value as per the Balance Sheet. The aggregation of these net asset values would be deemed to be 'accreted income' on which tax shall be paid at the maximum marginal rate which the Act defines as the rate applicable to the highest slab of income of an individual (and AOP / BOI) as increased by surcharge as specified in the Finance Act of the relevant year.

There is a provision for reducing from the quantum of accreted income, the net asset value attributable to assets created out of agriculture income or those acquired before registration under section 12 AA became effective.

It is pertinent to note that the tax on accreted income will have to be paid in spite of

the fact that no income tax is otherwise payable by the trust on its income computed in accordance with the provisions of the Act. As for example, a trust not required to pay income tax on its income, having spent more than 85% on religious / charitable purposes.

It is also of paramount alert to note that the trustees and principal officers of the trust such as secretary, treasurer, manager and others connected with the management or administration of the trust or a person thought to be the principal officer of the trust by the assessing officer, shall also be liable to pay the tax on accreted income within 14 days of the lapse of period provided for filing appeal before the Tribunal or when such appeal of the trust goes against it.

Implications and Repercussion of Section 115 TD

What strikes imminently on review of Section 115 TD is that –

i) There has been a sudden departure in looking at public trusts as centres prone to indulging in deliberate evasion of tax.

Section 10 of the Act highlights a plethora of tax exemptions expanded gradually over the years. This is in Chapter III of the Act which deals exclusively with exemptions. Sections 11 to 13B are the part of this Chapter on Exemptions. Computation of taxable income follows after Chapter III on Exemptions. Sections 11–13 make a room for special status of exemption where the legislature proposes to take a generous view at the backdrop of Charitable and Religious objects for which trusts are created.

This view has been progressively nurtured over the decades in spite of the fact that adequate precautions are taken for their tax monitoring to ensure that they genuinely stand for the objects for which they are created and recognised as such. In case, they do not stand on that premise, they tend to be refused registration under the Act or even cancelled an already granted status when they lose the character of being genuine or compliant, within the meaning of Section 12AA.

It is of utmost significance that when the Act provides for exemption under section 10 onwards under Chapter III, there is a legislative generousness in grant of exemptions. Even when the exemption is refused or withdrawn, the genesis of generousness may not be lost sight of.

The element of generousness is apparent over decades while dealing with exemptions under section 11, 12 and 13. A counterfeit or non compliant trust was meted out a treatment of non recognition or withdrawal of recognition. That was considered enough for decades, which was in keeping with the norms of statutory wisdom and reasonableness.

ii) The tone and the tenor of Section 115 TD is of punishing a wrong doer trust whose wrong, as though, tantamounts to a quasi - crime. Such an approach for correction of wrong is not reasonable while dealing with charitable trusts. The legislature needed to be conscious in a welfare state that by virtue of Section 115 TD, they are introducing a visibly punitive measure in the context of a religious or charitable trust.

iii) It ought not to be a strictly punitive measure; else it would have found inclusion in Chapter XXI of the Act which provides for penalties. Chapter XXI having been kept outside the purview of default anticipated by Section 115 TD, a measure suggesting a penal tax should not have formed part of assessment proceedings automatically. Action under section 115 TD is not confined to the Commissioner of Income Tax only, is what is all the more important.

iv) Section 115 TD provides for a scrutiny by the assessing officer into alleged modification of objects which do not conform to the conditions of registration, which is a highly subjective matter. This is a debatable area where there is a host of case laws available which has found fault even with the Commissioner's finding as to genuineness of activities of the trust or their purported objectives for eligibility under sections 11 and 12.

In Kalinga Institute of Industrial Technology vs CIT & Another, an unreported judgement of 1st October 2010 (WP (C) No. 14886 of 2009) the Orissa High Court observed -

"The power under section 12AA (3) has been enunciated under the Act is an unbridled power in

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the hands of the Commissioner of Income Tax to safeguard the interest of Revenue as and when he is satisfied to do so. It does not mean that this unbridled power given by the Act after much deliberation in Parliament should be utilised without clear cut satisfaction. As per strict judicial discipline, we consider that power of punishment is a unbridled power like the present power of cancellation envisaged under section 12 AA (3). But such unbridled power should be utilised quite cautiously and consciously. With the aforesaid findings, we are of the considered opinion that the order of the Commissioner of Income tax is a premature one which has been utilized at a premature stage in haste.

Further, it is difficult to conceive how a trust would apply for fresh registration under section 12AA during the previous year itself, as required by Section 115 TD (3)(ii)(a), for which the assessing officer alleges modification of objects. This is because ordinarily, such modification, if any, would come to his notice after the end of the said previous year when assessment is taken up.

Accordingly, the assessee succeeds in its appeal regarding continuance of registration."

The writ petition of the trust was accordingly allowed.

Now, the Commissioner's power under section 12AA (3) and (4) has been allowed to be lowered down to regular assessment of trusts, under section 115 TD, thus paving way for larger litigation. It will be the assessing officer who will decide whether the trust has adopted or undertaken modification of its objects not conforming to the conditions of registration, or has merged itself with any entity not having objects similar to that of the assessee trust. If he takes this view, he can compel the trust to apply for a fresh registration under section 12AA and subject it to a fresh round of formalities before the Commissioner, to obtain new registration. Else, payment of tax at MMR on Accreted Income would be the fait accompli that awaits the non conforming trust.

This would invariably be a fallout on cancellation of registration under section 12AA by the Commissioner. Further, it is difficult to conceive how a trust would apply for fresh registration under section 12AA during the previous year itself, as required by Section 115 TD (3)(ii)(a), for which the assessing officer alleges modification of objects. This is because ordinarily, such modification, if any, would come to his notice after the end of the said previous year when assessment is taken up.

v) The 'accreted income' purported to be taxed on erring trust is virtually the ascertainment of net wealth of the trust which is subjected to wealth tax under the garb of Income Tax. The rigidity with which the concept of fair market value and strict valuation norms for assets are introduced, suggest a tax on wealth, whatever is the nomenclature of tax. A challenge to the legal validity of this levy may not, therefore, be ruled out.

vi) It is interesting to note that measure as contemplated by Section 115 TD was not considered necessary for about 6 decades while dealing with lacs of trust assessments, their registration or eventual cancellation. It is difficult to visualise the experiences that warrants inclusion of this measure in the statute book.

vii) Eventually, it would not be prudent to introduce this measure and expose the entire class of trust assessees to a blanket provision as that of Section 115 TD which is subjective.

viii) It may not be out of context to point out that a demand of tax on accreted income does not take into account cash liquidity that may not be available with a trust to pay the tax at MMR on the net wealth calculated at a fair market value. Typically, a trust with enormous fair market value of assets (especially immovable property acquired decades before or even a century before) may be facing ironically a liquidity crunch after having spent a minimum of 85% on the Charitable / Religious objects to qualify for its income being exempt under section 11.

For paying a huge tax burden that Section 115 TD postulates, it may not be unlikely that the trust is called upon to liquidate some of its precious assets.

Leave alone a tax consideration, such a development may lead to hamper the smoothness in its avowed activities, or stall them altogether. A situation may also be perceived where trustees are not authorised to dispose off the trust property, by the authors of the trust. This could be an unintended complexity brought about by Section 115 TD.

A case for reconsideration:

The entire scenario as emerging from the implication of Section 115 TD needs to be reviewed to make it result oriented in a positive manner.

The uncalled for control is visible in Section 115 TD

- *in allowing assessing authorities to perform the powers of the commissioner.*
- *in quantification of accreted income which denotes the ascertainment of net wealth and not income at any rate.*
- *in taxing public trusts at maximum marginal rate; an apparently unreasonable measure in terms of the scheme for exemption.*
- *in making trustees and principal officers accountable for payment of tax.*

A measure for streamlining tax compliance by public trusts needs to be conscious that they ought to be compliant simultaneously under the laws governing public trusts which are keen to see that the trusts function effectively to cater to the objects for which they are formed. A tax provision needs to be handled accordingly in the interest of maintaining harmony which allows charitable / religious objects to be pursued unhindered, although they do not stand the yardstick of Section 11-13. In a situation like this, denial of registration under section 12 AA is the simple answer. This denial alone will be an indicator of generousness which will be in tune with the spirit of making a provision for exemption. The tax under section 115 TD connotes a redundant penal levy which does not fit into the scheme framed under sections 11-13 which is already comprehensive. ■

Ref : Section 115 TD of the Income Tax Act, 1961 and Rule 17 C B of the Income Tax Rules, 1962.