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No. MCS/149/2019-21 / R.N.I. No. MAHENG/2012/47041 - Total Pages: 216

THE CHAMBER'S JOURNAL

Vol. VIII | No. 3
December 2019

Your Monthly Companion on Tax & Allied Subjects

Charitable Organisations

Part II

DONATE

Trust Deed

TRUST

(N.G.O / N.P.O)

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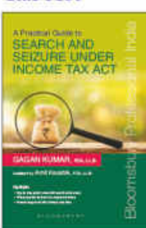

This book is an easy reference and a what to do guide to deal with real life search cases under the Income-tax Act, 1961. Book covers the journey from issuance of search authorization until the tax collection after the assessment of search cases. It would be extremely useful for Chartered Accountants, Tax Lawyers, Common Man and Tax Officers alike.

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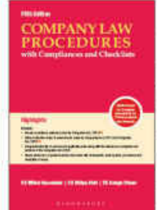

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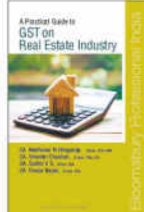

The purpose of this book is to enable the taxable person to understand the applicability and impact of GST provisions with respect to the Real Estate Industry. The comprehensive and in-depth practical knowledge of the four authors would help in implementation of the provisions in an easy manner.

CA Madhukar N Hiregange, CA Virender Chauhan, CA Sudhir V S and CA Roopa Nayak
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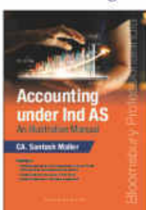

Ind AS transition has resulted in high-quality, principles-based, globally comparable financial reporting of large Indian companies. The transition not only impacted the financial results of companies, but also caused far reaching consequential business impact. Since last two years, there have been several changes in Ind AS for example, amendments in the revenue recognition standard and new leases standard has drastically changed the performance reporting in the balance sheet composition of companies.

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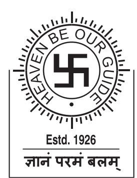

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Editorial

JUSTICE

"Of the People ……… For the People ……… <u>By the People</u>"

It seems, the challenges India is made to face are not in mood to subside, with the latest being the development about the "mob justice" at Hyderabad.

It was, indeed, quite shocking to watch/read about the horrific and chilling incident of the rape and the subsequent burning of the young doctor at Hyderabad. Undoubtedly, such barbaric and ghastly act is condemnable in strongest terms, deserving quick and severest punishment possible for the culprits. However, what is disturbing is the way the 'justice' is claimed to have been accomplished, by 'bumping off'' the alleged four criminals [including minors] at the hands of the so called 'encounter specialist' and trigger-happy police officer; so openly, so blatantly and with so absolute impunity! It was shocking to see the reaction of the people to such killings, with worshiping of the officer like a war hero!

But the more shocking was the reaction of the people from educated class and the people holding high position in public, openly supporting such quick-fix and instant justice delivery system. Even if such utterances were either due to immediate impulsive reaction or due to an endeavour to create/boost one's public image by projecting to be on the 'right' side of the public mood of the time being, they depict sheer ignorance and lack of understanding about the far reaching implications of such 'encounter killings'.

Granted, the element of anger, frustration and helplessness over not only the brutal murder of the lady but also over the very dismal state of our criminal justice system might have played a role in such public reaction. However, in such mob frenzy and euphoric/victorious state of mind, what is lost sight is very serious and adverse effects of such 'encounter killings', with such heroic support to it.

Apart from the fact that such a system is alien to a civilised and democratic society, such a response is counter-productive in the long run. The fundamental legal dictum "Justice is Blind" is not merely a philosophical, academic or decorative dictum, but is based on very sound practical considerations. Respect for law and due process of law are the very foundation for a strong and sustainable legal system, without which there will be chaos and anarchy. The issues that arise with such an alternate system, which seeks to give the criminal jurisprudence and due process of law a

go-by, are: Who will decide whether a person is guilty or not? Who will decide what punishment to be given, by whom to be given and how to be given? The line between right and wrong, between real and fake, is otherwise also too thin and blurred, with ulterior purposes and intents can never be ruled out, so as to justify such a parallel system.

Instead, all these public outrage and mob energy should be channelised and moulded to ensure that the criminal justice delivery system is quick, efficient and robust. One also hopes that the public displays such strong reaction and adopts 'pro-active' stand to protest against other evils that our nation is besieged with at present and for productive cause. Joining the bandwagon in such mob frenzy may reflect an act of tokenism!

Otherwise, we may have to watch with dismay the words 'Kangaroo Court' and 'Jungle Raj', which are so far synonymous to lawless rough regimes, are also referred in the context of India.

This second part of Special Story on "Charitable Organisations (NGOs/NPOs)" deals with very vital and fundamental taxation and accounting aspects, apart from with other applicable laws. Together, the two parts cover all major aspects concerning NGOs/NPOs which, I am sure, the readers will find very useful.

Wishing all readers Merry Christmas and a very Happy and Healthy New Year, in advance!

Vipul B. Joshi
Editor

From the President

Dear Members,

After the hectic season of Tax Audits followed by Transfer Pricing Audits, the professionals will now be busy in attending the time barring assessments.. Everyone would be looking forward to a small vacation before the onset of the New Year! With the new e-assessment procedure applicable from A.Y. 2018-19, there will bea sea change in the way the assessments will be done. It is anybody's guess whether the new e-assessment procedure would make life of the assessee as well as professionals easier or tougher!

The recent RBI Monetary policy has generally disappointed the industry by not reducing the repo rate after cumulatively bringing it down by 135 basis points since February 2019. RBI has cited inflationary pressure as the main reason for not reducing the repo rate. Besides this, the GDP growth rate estimate for FY 20 has been reduced from 6.1% to 5%. This is, sadly, not a healthy sign and this in turn may have a direct effect on the fiscal deficit. Overall economic scenario of the country thus continues to be uncertain, weak and worrisome. The Government seems to be clueless and is sitting quiet about the state of affairs. Some drastic measures have to be taken by the Government to revive the economy and overall financial health of the country.

After a lot of political drama in Maharashtra, three political parties with different ideologies have come together, nominated the Chief Minister and proved their majority, but no portfolios have yet been allocated. Hope this Government gives stability to the State comprising Nation's Financial Capital.

I am very happy to inform you that the Indirect Tax RRC at Fairmont, Jaipur has received overwhelming response and we have closed the registration at total enrolment of 323 delegates. The Indirect Committee deserves all the compliments for its stupendous efforts. The Direct Tax RRC at Coimbatore also has received very encouraging response and the enrolment has crossed 200 delegates. The RRC is a unique opportunity for everyone to learn, rejuvenate and connect with the professionals. I am sure those of you, who could not enrol for the RRC due to the hectic professional work season, which just got over, will find time to enrol for the RRC. The Commerce and Allied Laws Committee has organized a three day conclave from 13th to 15th March 2020 on Securities Law jointly with National Institute of Securities Market at NISM Campus Patalganga. Such a conclave on this subject is being organized for the first time by Chamber with an educational institute promoted by SEBI and eminent professionals will be the faculty. I am sure professionals practicing in this area and also those wanting to develop practice in this area, will take advantage of this conclave and enroll for the same.

All the committees are now gearing up for conducting programs for the benefit of our members. The Students Committee also has planned a lot of programmes including the essay and debate competition which will benefit the students. All work and no play makes jack a dull boy! Keeping in mind this famous adage, like last year, this year also, we have organized an Inter Firm, Indoor Box Cricket Tournament on 15th February, 2020. Do participate and get rejuvenated!

The past month witnessed a lot of Study Circle meetings conducted by all the Committees as well as by the Pune, Bengaluru and Hyderabad Study Circles, which were well received. The workshop on Office Productivity, Technology Tools and Tips organized by the IT Connect Committee was so well structured, giving practical tips to the professionals, and expectedly, it met with such a good response and we had to refuse enrolment to a few.

The budget preparation exercise of the Government has begun and requests have started coming in for suggestions. The Law & Representation Committee has geared itself up for another strong and relevant representation document to be presented shortly to the Government. I am very happy to inform you that The Chamber was invited by the CBDT on 5th December to give suggestions for the budget. The deliberations with the Chairman and the officials of the CBDT were very fruitful and the officials were very positive about the suggestions which The Chamber has made. The pre budget memorandum presented to the CBDT is available on Chamber's website.

This issue of the Journal is the second part of the two part special story on the subject of Charitable Trusts. Provisions relating to Charitable Trusts under the Income-tax Act as also various other laws relating to Public and Charitable Trusts have been substantially amended over the past few years and therefore it was necessary to bring out this issue on the subject. Due to vastness of the subject, the issue has been divided in two parts. I thank CA Vipin Batavia for designing the issue on this subject. I express my sincere gratitude and appreciation to the authors of the articles for sparing their valuable time and sharing their knowledge.

Before I conclude a food for your thought, A Sanskrit Subhashitam.

"सुवर्णपुष्पां पृथिवीं चिन्वन्ति पुरुषास्त्रयः

शूरश्च कृतविद्यश्च जानान्ति सेवितुम्

कृतविद्यश्च जानाति"

One who is brave, has acquired excellent knowledge or knows the art of giving perfect service, is capable of plucking golden flowers in this world.

Wishing you and your family a Merry Christmas and very Happy and Fulfilling New Year 2020!

We are here to serve you better. Therefore I would be happy to receive any suggestions that you have at president@ctconline.org.

VIPUL K. CHOKSI
President

Do's and Don'ts under Income-tax Act, MPT Act and ROC (For CAs & Trustees)

CA C. N. Vaze

About two decades ago, the approach of Revenue Authorities and other regulators towards charitable institutions used to be rather lenient and considerate. So long as the charitable entity was doing genuine good social work, the procedural defaults were not viewed that seriously. The authorities and especially the Courts used to be favourably inclined to condone the delays and pardon the lapses. However, times have changed. The Governments all over the globe started realising that quite a few trusts (NGOs/NPOs) were taking undue advantage of the tax exemptions and liberal approach. It was observed that there was a lot of indiscipline, mismanagement, manipulations and non-compliances. Law was being taken rather lightly. As a result, the laws and regulations changed very rapidly.

The increasing digitalization also hastened the process of tightening the norms. Everything is now required to be done within the prescribed time and online. Thus, the scope for manipulation has been reduced significantly, if not eliminated. In a way, there is a justification to this new approach of discipline. If you enjoy tax exemptions, you need to observe the rules of the game very strictly. In any charitable trust public money is involved in more than one ways. Firstly, many people may give donations and avail the benefit of tax saving in terms of Sec. 80-G etc. Secondly, the trusts are exempted from payment of tax and indirectly the Government loses revenue. In a way, it is the Government's contribution to the charitable activity. Further, the trusts also receive direct financial support in terms of grants or aid from the Government and other agencies. Naturally, all this needs to be closely monitored and regulated.

The first such serious procedural amendment was introduced by Finance Act, 2007 w.e.f. 1-6-2007, when the power of the Commissioners to condone the delay in granting registration u/s. 12A was withdrawn. Earlier, delays of even 20 or more years used to be condoned.

Against this background, the Trustees, Accountants, Auditors and practitioners need to keep in mind the following important points:

Under Income-tax Act, 1961

1) Obtain registration u/s. 12AA by applying in Form 10A to the Principal Commissioner or Commissioner of Income-tax.

   If a trust which is registered u/s. 12AA adopts or modifies any object clause which

does not conform to the conditions of registration then it shall apply for the modified registration certificate u/s. 12AA within 30 days from the date of said adoption or modification.

		Relevant Last Date
2)	Submission of Income Tax Returns within the prescribed time If gross receipts exceed ₹ 2,50,000/- If not filed, no exemption available	30th September
3)	Form 10B – audit report must be filed along with the return Section 12A(1)(b)	30th September
4)	Form 10 for accumulation of income over next five years must be filed along with the return Section 11(2)	30th September
5)	Form 9A - application for spending the income in the following year must also be filed along with the return Clause (2) of *Explanation* (1) to Section 11(1)	30th September
6)	Form 56D - If the total receipts exceed ₹ 1 crore, application to CBDT for approval must be filed in time [10(23C)] – For exclusively educational or medical institutions.	30th September
7)	Tax deducted at source on various payments must be paid in time - otherwise 30% of the relevant expenditure will be disregarded **Section 40(a)(ia)** - *Explanation* (3) to Section 11(1)	**Before 7th of next Month/ Finally before 30th September**

8) Every expenditure in excess of ₹ 10,000/- must be paid by crossed account payee cheque or account payee bank draft or use of electronic system through a bank account (not in cash) - otherwise it will be disregarded. **Section 40A(3)** - *Explanation* (3) to Section 11(1).

9) In case of receipt of donations,

- Do not accept donation above ₹ 2,000/- on a single occasion in cash –otherwise the donor will not get deduction under section 80G.
- A note to that effect may be mentioned on the receipt either by printing or putting rubber stamp so that the donor is cautioned.
- 80G no of the trust to be printed on receipt. So also, the PAN of the Trust.
- Receipt should contain name and address of the donor.

In case of a large donation (above ₹ 10,000/-) also obtain PAN of the donor.

10) Donation given to the corpus of another trust will not be treated as application by the payer trust i.e. it will not be allowed as deduction. *Explanation* (2) to Section 11(1)

11) If purchase of a fixed asset is once claimed as a deduction (application of income), no depreciation will be allowed on the same asset. Hence, one has to keep track of the claims made.

12) Obtain Corpus directions letter from the respective donors.

Note: **For the proper compliance of all the above-mentioned points, the trustees should be more serious and ensure the finalisation of accounts preferably by 31st May. It is in the trusts' interest to approach the consultant pro-actively. This will avoid penal consequences and embarrassment. Trustees are also advised to ensure timely maintenance of all documents like minutes-book, vouchers, correspondence, registers, etc.**

Don'ts (under Income-tax Act)

Having discussed the Do's, as a corollary, the Don'ts obviously are to scrupulously avoid the delays and deviations. Even a single day's delay may prove disastrous. It will not be affordable for any trust to take these compliances lightly. Now there is almost no human interface and papers are processed mechanically. The CPC functioning is a nightmare and getting things rectified is a herculean task.

A few specific "don'ts" would include:–

Do not make investment in shares or any mode other than those specified u/s 11(5) - Section 13

Do not spend any amount; or do or omit to do any act that would enure a 'benefit' to a specified person.

If a trust is charitable (and not religious), do not spend any amount on religious activities in excess of five per cent of its income – Section 80G (5B)

Do not receive any anonymous donations in contravention of the provisions of Section 115 BBC.

Do not take secretarial work lightly – e.g., holding of meetings as per the constitution/bylaws, issuing notices, maintaining minutes, submission of change reports, maintaining other registers and records, correspondence, etc. Such paper work and documentation is extremely crucial.

Ensure recording of resolutions affecting the income tax e.g. accumulation u/s. 11(2).

Do not take up or continue any activity in deviation of your objects clause.

Under Maharashtra Public Trusts Act, 1950

Charitable Trusts are doing major work for development of the society in various areas like Health, Agriculture, Education, Environment, etc.

Charitable Trusts in India are governed by different Acts.

In Maharashtra the 'Maharashtra Public Trusts Act 1950" (MPT Act 1950) is in existence. Previously, it was "The Bombay Public Trusts Act 1950". Around 8 Lakh to 10 lakh registered trusts are there in Maharashtra, which come under the jurisdiction of office of the Charity Commissioner, Maharashtra, governed by Ministry of Law and Judiciary. Since the year 2016-17, statewide deregistration drive was carried out by the Office of the Charity Commissioner, Maharashtra. Under this, around 4 lakh trusts were deregistered due to non-compliance of change reports and audited statements.

The MPT Act is also now becoming digital and some of the procedures are now available online.

Following care (Do's) is to be taken by every operational trust in respect of compliance under MPT Act, 1950.

1) Change Reports,

2) Audit of Trusts and submission of the relevant statements

3) Record of Property

4) Updating of Schedule-I of the Trust

5) Budget for the next Financial Year as per rule 16A.

Change Report

As per section 22 of the MPT Act, 1950, in case of occurrence of any of the following events/Changes, a Change Report is required to be submitted to the concerned Public Trust Registration (PTR) office within 90 days from the occurrence of such event/change:

i) Change in Board of Trustees & Change in Office Address

a) When the tenure of the existing Board of Trustee is over and new Board of Trustees has been elected

b) When any of the Trustee(s) resigns voluntarily or has expired and the new Trustee is appointed in his place

c) If the registered office of the Trust is also changed, then the address also needs to be updated in Charity Commissioner's office.

The procedure under Rule 13(1) of the Maharashtra Public Trusts Rules, 1951 is required to be adopted for the same.

ii) Audit of the Trusts

As per Section 33 & 34 of MPT Act audit should be completed by the Trust. The Audited financial statements should be uploaded on the official website of Charity Commissioner's Office within six months from the end of every financial year. The audited financial statements are namely, as per Rule 19, Schedule IX (Income and Expenditure account), Schedule VIII (Balance Sheet) and Contribution to PTR fund as per Section 58 & also Schedule IX-C.

Now, from the year 2016-17, the audited financial statements are in completely digital formats. In case of pendency, audited statements of 12 preceding years can be uploaded online.

iii) Records of Trust Property

It is observed that as on today many of the trusts are having their immovable properties like buildings, lands which may be owned by the Trust or taken on lease for a certain period from any Government body/other party.

Such properties/assets should be taken on the records of the respective Public Trust Registration Office as per Section 36 of MPT Act 1950 and entries of such assets should be available on Schedule-I of the Trust kept at respective PTR office. This will be helpful during redevelopment/sale of immovable properties.

iv) Updating Schedule-I of the Trust

As per 2nd amendment in Maharashtra Public Trusts Rules, 1951 (previously Bombay Public Trusts Rules, 1951) Schedule-I is an important document of the Trust, which is now available online. Trustees can update trust's schedule-I entries online on their own after adopting certain procedure developed by Charity Commissioner's Office Maharashtra.

v) Budget Submission

As per Rule 16B of the Maharashtra Public Trusts Rules, 1951, the budget of the Trust should be submitted online for the next financial year. Now the budget format as per Schedule-VII is available online on the website of Charity Commissioner's Office, Maharashtra. The same is mandatory

for any trust and useful in case of CSR Funding applications.

Other than the above points, all the documentation like minutes books, records of proceedings should be maintained properly.

Under Companies Act, 2013

Do's for a Section 8 Company

1. **Name of the Company:** As per Rule 8(7) of the Companies (Incorporation) Rules, 2014, for the Companies under Section 8 of the Act, the name shall include the words Foundation, Forum, Association, Federation, Chambers, Confederation, Council, Electoral trust and the like.

2. **Articles of Association of a Section 8 Company:** The Articles of Association of a Section 8 Company can have entrenchment clause in terms of provisions of section 5(3), if such clause is there, then the relevant restrictions should be followed.

3. **Alteration of object Clause:** The objects of Section 8 Company can be altered only by taking shareholders' approval and approval of Registrar of Companies in terms of Section 8. Consequently certificate u/s. 12AA of Income-tax Act also needs to be modified.

4. **Election of directors by ballot:** If election of directors by ballot is not prescribed in the Articles then, section 160 applies and consequentially a deposit of ₹ 1 lakh is mandatorily required to be taken from persons standing for director's election.

5. **Number of Board Meetings:** At least one meeting within every six calendar months should be held.

Don'ts for a Section 8 Company

1. **One Person Company:** A "One Person Company" (OPC) cannot be incorporated or be a member of Section 8 Company.

2. **Proxy:** In terms of Rule 19 of the Companies (Management and Administration) Rules, 2014, a member of a company registered under section 8 shall not be entitled to appoint any other person as his proxy unless such other person is also a member of such company.

3. **Independent Director:** It is not mandatory for a Section 8 Company to appoint an Independent Director.

4. **Bonus Shares:** A Section 8 Company is prohibited from issue of bonus shares to members.

5. **Amalgamation:** Section 8 Company cannot be amalgamated with a company which is not a Section 8 company

Note: The auditors are expected to verify all the records of the Charitable Institution (Trust, Society or Company) with reference to all these Acts and keep proper working papers for themselves.

The readers may please note that the articles covered only the important points under the respective Acts and it is not an exhaustive list.

❍❑❍

Income Excluded - Section 10(23)(C)

CA Vipin Batavia

The income of any University and other educational institutions, Hospitals and other medical institutions exist solely for educational and medical purposes are established not for the purposes of profit, their incomes are excluded u/s. 10(23)(C).

1) Any income received by any person on behalf of –

   Section 10(23)(C) sub-section..

   (i) the Prime Minister's National Relief Fund

   (ii) the Prime Minister's Fund (Promotion of Folk Art); or

   (iii) the Prime Minister's Aid to Students Fund, [or]

   (iiia) National Foundation for Communal Harmony; [or]

   (iiiaa) Swachh Bharat Kosh, set up by the Central Government; [or]

   (iiiaaa) the Clean Ganga Fund, set up by the Central Government; [or]

   (iiiaaaa) the Chief Minister's Relief Fund or the Lieutenant Governor's Relief Fund in respect of any State or Union territory,

2) The other sub sections (iiiab), (iiiac), (iiiad), (iiiae), (iv), (v), (vi) & (via) can be divided in three categories of exemption –

   (i) Wholly or substantially financed by the government covered u/s. 10 (23C) (iiiab) – Universities or Other Educational Institutions existing solely for educational purposes and not for purposes of profit & (iiiac) – Hospital or other institutions for reception treatment of person suffering from illness or other diseases mentioned in the provision or of persons requiring medical attentions or rehabilitation, existing solely for philanthropic purposes and not for the purpose of profit. (As per rule 2BBB the prescribed percentage for substantially financed by Govt. is more than 50%.

   (ii) The aggregate annual receipt does not exceed the amount as may be prescribed. Covered u/s-10 (23C) (iiiad–Educational) & (iiiae - Medical). (As per Rule 2BC the said amount prescribe is ₹ 1 Crore)

   (iii) The aggregate annual receipts exceeds the prescribed amount (₹ 1 Crore) are required to obtain approval from prescribe authority to avail exemption covered U/s. 10(23C) (iv) – having regard to objects of the

fund or institution and its important throughout India and through any state or states, sub-section (v) – any trust (including legal obligation) or institution having regard to manner in which the affairs of the trust or institution are administered and supervised for ensuring that the income approving thereto is properly applied for the objects thereof, sub section (vi) – any university or other educational institution other than those mentioned in sub clause (iiiab) or (iiiad), sub-section (via) – any hospital or other institution other than those mentioned in sub clause (iiiac) and (iiiae).

The approval is to be obtained from Chief Commissioner/Director General of Income Tax. The application for such approval is required to be sent (under rule 2C & 2CA *vide* form Nos. 56 & 56D) through the commissioner of Income Tax having jurisdiction over the Hospital and other medical institution, University or other educational Institution. (Section 10(23C)(iv) to (via)

3. Some important FAQs on Educational Organisations

3.1 What is Education

As per Common Parlance, the term 'education' refers to imbibing of knowledge. It involves imparting of knowledge to the students. The process evolving between teachers and the students is knowledge and that knowledge is 'education'.

The word 'education' connotes the process of training In and developing the knowledge, skill, mind and character of students by normal schooling as held in the case of ***Sole Trustee, Loka Shikshana Trust vs. Commissioner of Income Tax, Mysore (1975) 101 ITR 234 (SC).***

Education also includes all kinds of coaching and training ultimately leading to personality development in a systematic manner as held in the cases of ***CIT vs. St.Mary's Malankara Seminary (2012) 348 ITR 69 (Ker)*** and ***Little Angels Shiksha Samiti vs UOI (2011)39 (I) ITCL 192 (MP).***

3.2 What are the conditions to be satisfied to get the benefit of exemption? -

To get the benefit of exemption under Sec. 10(23C)(iiiab), (iiiad) and (vi), the university or other education institution has to satisfy all the following conditions:

a. There should be an existence of a university or other educational institution;

b. It should exist solely for educational purposes;

c. It should not function for the purposes of profit; and

d. The institution should be wholly or substantially financed by the Government or the aggregate annual receipts should not exceed the amount of annual receipts, as may be prescribed or which may be approved by prescribed authority.

3.3 What is the meaning of university?

Section 2f of the University Grants Commission Act, 1956 reads as under:

"'University' means a University established or incorporated by or under a Central Act, a provincial Act or a State Act, and includes any such institution as may, in consultation with the University concerned, be recognized by the commission in accordance with the regulations made in this behalf under this Act"

3.4 Does University include deemed university also?

The expression university as referred to in s. 10(23C) (iiiab) includes deemed university also. The deemed university has the status of the university.

3.5 What is the meaning of the expression 'other educational institutions?

The word 'institution' has not been defined in the act. The expression other institution has been used in broad sense that can be a trust, society or section 25 company.

3.6 Whether the sources of income are relevant for providing exemption?

Yes. This position was upheld in the under noted cases:

- ***Additional Commissioner of Income Tax, Madras-I vs. Aditanar Educational Institution (1979)118 ITR 235 (Mad)***
- ***Katra Education Society vs. Income Tax Officer, "A" Ward Allahabad (1978) 111 ITR 420 All)***
- ***Governing Body of Rangaraya Medical College vs. Income Tax Officer, A-ward, Circle I, Kakinada (1979) 117 ITR 284***
- ***Birla Vidhya Vihar Trust vs. Commissioner of Income Tax, Central I, Culcuutta (1982) 136 ITR 445***
- ***Commissioner of Income Tax Gujarat-IV vs. Sindhu Vidya Mandal Trust (1983) 142 ITR 633 (Guj)***
- ***Commissioner of Income Tax, West Bengal VII Calcutta vs. Doon Foundation (1985) ITR 208 (Cal)***

3.7 What is the meaning of Expression 'solely for educational purposes'?

The expression 'solely' means exclusively and not primarily. Bare reading of it is that the 'educational institution' must exist 'solely' for educational purposes as held in the case of *Commissioner of Income-Tax vs. Maharaja Sawai Mansinghji Museum Trust (1988) 169 ITR 0379 (Raj)*

The expression conveying 'solely' means exclusively has been upheld in the following cases:

- ***Vanita Vishram trust vs. Chief CIT & Anr (2010)3027 ITR 121 (Bom)***
- ***CIT vs. Gurukul Ghatkeswar of Trust (2011) 332 ITR 611 (AP)***
- ***Oxford University Press, Etc. vs Commissioner of Income Tax (2001) 247 ITR 0658 (SC)***
- ***Governing Body of Rangaraya Medical College vs. Income Tax Officer, A-Ward, Circle- I, Kakinada (1979) 117 ITR 284 (AP)***
- ***Aditnara Educational Institution vs. Additional Commissioner of Income Tax (1997) 224 ITR 310 (SC)***

3.8 When there are several objects in the Constitution along with educational objects, in such a case, will it be regarded as 'solely for educational purposes?

If the dominant purposes of an institution is educational another objects which are merely ancillary or incidental to the dominant purposes would not disentitle the institution from the benefit. The test which, therefore, to be applied is whether the object which is said to be non-educational, is the main object of the institution or it is ancillary or incidental to the dominant object which is 'educational" This Principle was held in the case ***Simpkins School vs. Director General of Income-tax***

(Investigation) & Ors. (2014) 367 ITR 335 (All)

3.9 What is the meaning of expression 'not for the purposes of profit?

The expression not for the purposes of profit in the context of university or educational institutions means that the intention behind the existence of these institutions is not for commercial exploitation. It is not intended to make profit. It is important to ascertain the intention of such institutions. Mere profit does not indicate as intention of profit.

3.10 Whether the unreasonable profit would give indication for 'not for profit'?

The expression 'not for the purpose of profit 'as occurring in section 10(23C) denotes the sense that the profit should not be the result of intention to make profit. While judging the profit the reasonability test assumes importance. As long as there a reasonable surplus there should not be difficulty. But when under the guise of charity if a organization makes a huge profit then it would ceased to exist 'not for profit'. In such a case it would not be entitled for exemption as held in the case of ***Visvesvaraya Technological University vs. ACIT –(2004) 362 ITR 279***

3.11 Whether surplus shown in the financial statement amounts to intention of profit?

No. Merely reflection of surplus in the financial statement is not a determining factor. Various factors have to be looked into while determining the intention of these institutions.

The non-profit qualification has to be tested against activities. The excess/deficit of income over expenditure will not decide whether the applicant exists for profit or not, as held in the case of ***American Hotel and Lodging Association Educational Institution vs. CBDT & Ors (2008)301 ITR 86 (SC)***

In the undernoted cases, the principle laid was that incase of surplus, that is to say, a surplus of receipt over expenditure, it cannot be said that the educational institution exists for profit.

Aditanar Educational Institution vs. Additional Commissioner of Income Tax (1997) 224 ITR 310 (SC) and ***CIT vs. Karnataka Lingayat Education Society (2015) 371 ITR 0249 (Kar)***

3.12 Some judicial cases where income from university or an educational institution existing solely for educational purposes was held as exempt.

What is exempt is the income of the university or an educational institution existing solely for educational purposes and not for the purposes of profit 'as held in the following cases:

- ***Oxford University Press, Etc. vs. Commissioner of Income Tax (2001) 247 ITR 658 (SC)***
- ***CIT vs. Vidya Vikas Vihar (2004) 265 ITR 0489 (Bom)***

3.13 What is the meaning of the expression, financed by the Government as occurring in section 10 (23C)

The term 'financed by the Government' includes both the capital and revenue account because the word finance embraces on both capital and revenue account. When the Government provides finance wholly or substantially, either on capital or revenue or both together, it satisfies this expression.

- ***Maharashtra Rajya Sahakari Sangh Maryadit & Ors vs. ITO & Ors. (2011) 7 ITR (Trib) 675***

- ***CIT vs. Indian Institute of Management (2011) 196 Taxman 276 (Karn)***

3.14 *Whether donations received by educational institutions are exempted under section 10 (23C)*

This question came up in the case of ***Additional Commissioner of Income Tax, Madras-I vs. Aditanar Educational Institution (1979) 118 ITR 235 (Mad),***

Where it was held that donations received by educational institutions are entitled for exemption. Following other decisions also confirm it-

- ***Commissioner of Income Tax Gujrat –IV vs. Sindhu Vidya Mandal Trust (1983) 142 ITR 633 (Guj)***
- ***Commissioner of Income Tax Karnataka –I vs. Academy of General Education Manipal (1984) 150 ITR 135 (Karn)***
- ***Birla Vidhya Vihar Trust vs. Commissioner of income Tax, Central I, Calcutta (1982) 136 ITR 445, 454 (Cal)***
- ***Agrawal Shiksha Shamiti Trust vs. Commissioner of Income-Tax (1987) 168 ITR 751 (Raj)***

3.15 *Whether university or educational institutions must be in India to claim exemption*

Though the language used in Sec. 10(23C) does not specify, however considering the object of providing exemption under the scheme, university or educational institution should be in India to claim exemption. This position was confirmed by the Supreme Court in the cases of ***American Hotel & Lodging Association Educational Institute vs. CBDT & Ors (2008) 301 ITR 86(SC)*** and ***Oxford University Press Etc. vs. Commissioner of income Tax (2001) 247ITR 0658 (SC).***

3.16 *Can exemption be claimed under section 10(23C) for income from other sources?*

In the course of educational activity, the institution may derive an income other than education. In such cases, whether they lose exemption? It is to be noted that seventh proviso to sec. 10(23C) enables the trust or institution to carry on business activity subject to the condition that the activity must be incidental to the main activity and separate books of account are to be maintained. Hence for income derived for other sources, exemption can be claimed. Some examples are given below:

a. Income from plying of buses to children

   The School buses are used to facilitate transportation of children. The income from such activity would be treated as income from educational purposes.

b. Income from Interest on fixed deposit

   The interest income received on account of an investment is incidental to running the school. If this income is utilized for the main object of the educational institution, it is entitled to exemption. As held in the following cases:

   - ***Additional Commissioner of Income Tax, Gujarat vs. Surat Art Silk Cloth Manufacturers Association (1980) 121 ITR 0001 (SC)***
   - ***City Montessori School (Regd) vs. UOI & Ors (2009) 315 ITR 48 (All)***

- ***Brahmin Educational Society vs. Asst. CIT (1997) 227 ITR 317 (Ker)***

c. **Rent/Lease income from trust property- Building and terrace used putting for mobile phone towers -**

Applying the analogy of the decision of Brahmin Education Society (supra) and in the case of ***Rao Bahadur AKD Dharmraja Education Charity trust vs. CIT (1990) (182 ITR 80) (Mad)*** and ***Birla Vidya Vihar trust vs. CIT -136 ITR 445 (Cal)*** the income of educational institution from letting out its building, if meant for application of such income for education purposes, then such income will also be exempt from tax. The main criteria is to looked in to is the application of income solely for education.

3.17 Whether violation of section 13 could result in denial of exemption?

The preamble to sec. 13 clearly states that sec. 11 will not apply in case there is violation as contained in Sec. 13(1)(a) to 13(1)(d) and from secs. 13(2)(a) to 13(2)(h). The restrictions provided in sec. 13 will only apply to the cases covered under sec. 11. Section 10(23C) is an independent provision. Therefore, the question of application sec. 13 has no relevance.

3.18 Whether providing financial help to students amounts to education?

Providing financial help to students does not amount to education as held in the case of ***Commissioner of Income Tax, Karnataka-II, Bangalore vs. Saraswath Poor Students Fund (1984) 150 ITR 142 (Kar).***

3.19 Whether printing and publication books amounts to education?

Held no in the case of ***Oxford University Press, Etc. vs. Commissioner of Income Tax (2001) 247 ITR 0658 (SC).*** It was also upheld in the following cases that mere printing and publication of books will not amount to education.

- ***Saurashtra Education Foundation CIT (2005) 273 ITR 139 (Guj)***
- ***CIT vs. Assam State Book Production & Publication Corporation Ltd (2007) 288 ITR352 (Gau)***
- ***Assam State Book Production & Publication Corporation Ltd vs. CIT (2009) 319 ITR 317(SC)***
- However, held yes, in the case of Council for the ***Indian School Certificate Examination vs. Director General of Income Tax (2014) 362 ITR 0437 (Del).***

3.20 Whether running coaching classes for examination amounts to education?

There have been contrary views on whether running coaching classes for examination amounts to education. Held no in the following cases:

- ***Bihar Institute of Mining & Mine Surveying vs. CIT (1994) 208 ITR 0608 (Pat)***
- ***Saurashtra Education Foundation vs. CIT (2005) 273 ITR 139 (Guj)***
- ***Dy Director of IT vs. Kuttukaran Foundation (2012) 051 SOT00175 (Coach)***
- ***Centre for Policy Research vs. Brahma Chellaney & Ors (2010) INDLAW DEL 928 (Del)***

Held as education in the following cases:

- ***Institute of Chartered Accountants of India & Anr. vs. Director – General of IT (Exemptions) & Ors (2013) 358 ITR 0091 (Del)***

- ***Oxford Academy for Career Development vs. Chief CIT & Ors. (2009) 315 ITR 382 All).***

4. Some important FAQs for Hospital and medical institutions

4.1 What is the meaning of the expression 'hospital' as used in section 10(23C)?

The expression 'hospital has not be defined under the Income tax Act 1961, but in common parlance, hospital is an institute where there are facilities not only to treat the patient but also has in house facilities for treatment. In-house facilities means provision of beds and medical care. It must be identified as a hospital. To identify as a hospital, it must have the basic features of a hospital such as a premises, doctors, nurses and clinical facilities.

4.2 Whether Hospital includes a nursing home, clinic for treatment of persons suffering from illness or wound. This also extends to dispensary?

As per sec 2(e) of Artificial Insemination (Human) Act, 1995 (12 of 1996), 'Hospital' means any premises including a maternity home, nursing home, hospital or any other places not established or maintained by the government funds, used or intended to be used for storage, supply or artificial insemination of semen. This was upheld in the case of ***ABC Trust vs. ITO (1977) 4TTJ 1391 (Jp)*** and ***Mangilal Gotawat Charitable Trust vs. Commissioner of Income Tax, Karnataka (1984) 150 ITR 682 (Karn).***

4.3 Whether a trust or society can run a hospital and claim exemption?

Section 10(23C) not only refers to the income of a hospital but also of 'other institution'. 'Other institution' has not been defined. It means an establishment, organisation or association. The expression 'institution' has been used in broad sense. Therefore, it comprises trusts, companies also. Therefore, the expression institution includes a trust or society. This position was upheld in the following cases:

a. ***Additional Commissioner of Income Tax, Madras-I vs. Aditanar Educational Institution (1979) 118 ITR 235 (Mad)***

b. ***Director of Income Tax (Exemption) vs. A.M.M. Medical Foundation (2002) 257 ITR 0292 (Mad)***

c. ***Governing Body of Rangaraya Medical College vs. Income –Tax officer A-ward, Circle I, Kakinada (1979)117 ITR 284 (AP)***

d. ***CIT vs. Shree Narayana Chandrika Trust (1995) 212 ITR 456 (Ker).***

4.4 What is the meaning of the expression 'reception and treatment of persons suffering from illness or mental defectiveness'?

The expression 'reception and treatment of persons suffering from illness or mental defectiveness' in the context of hospital signifies in-patient as well as out-patient. Likewise treatment applies to both.

4.5 Whether providing medical attention and rehabilitation to persons qualify for exemption?

The medical attention and rehabilitation provided the patients will qualify for exemption under sec. 10(23C). Any hospital or other institution that provides medical attention and rehabilitation falls under this clause and therefore, such income is included.

4.6 What is the meaning of the expression 'existing solely for philanthropic purposes'?

Section 10(23C) provides that hospital or other institution must exist solely for philanthropic purposes and not for the

purposes of profit. the expression 'solely' means exclusively and not primarily.

4.7 *What is the meaning of 'philanthropic purposes'?*

The meaning of the word philanthropic purposes' includes activities promoting goodwill to mankind or activities beneficial to humanity at large as opposed to activity solely for the benefit of a few individuals. This position was upheld in the following cases:

a. ***Commissioner of income Tax vs. Pulikkal Medical Foundation Pvt.Ltd (1994) 210 ITR 0299 (Ker)***

b. ***Baun Foundation Trust vs. Chief CIT & Anr. (2012) 45 (I) ITCL 550 (Bom)***

4.8 *Whether philanthropic purposes mean free medical services?*

The philanthropic purposes will not always mean to provide at free cost of services medicine, consultation to patient etc. Charging of fees will not detract the principle of charity or philanthropy. Altruism and charity are essential as held in the case of ***Commissioner of Income-Tax, Bombay City – III vs. Trustees of Dr. Divekar Charity Trust (1977) 110 ITR 227 (Bom).***

4.9 *What is the meaning of 'annual receipts'?*

Annual receipts' means the aggregate annual receipt of the hospital or other institution from providing medical treatment. In other words receipt is from treatment sources

4.10 *What does 'approved by the prescribed authority' as mentioned in section 10 (23C) (via) mean?*

Section 10(23C)(via) provides that those hospitals or other institutions that may be approved by the prescribed authority are entitled to claim exemption.

The guidelines for approval under sub-cl (via) of sec. 10 are given in provisos to sec. 10(23C) and rule 2CA of the Income Tax Rules, 1962. These guidelines and requirements are explained in chapter 52-Requirements as per provisos to Section 10(23C) Applicable to Educational and Medical Institutions.

4.11 *For claiming exemption, whether the source of income is relevant?*

While considering the exemption under sec. 10(23C) what is important is the source of income. The income should be derived from treatment of persons suffering from illness etc.

This position was upheld in several cases as mentioned below:

a. ***Commissioner of Income Tax, West Bengal-vii, Calcutta vs. Doon Foundation (1985) 154 ITR 208(Cal)***

b. ***Agarwal Shiksha Samiti Trust vs. Commissioner of Income Tax (1987)168 ITR 751 (Raj)***

c. ***CIT vs. Sree Narayana Chandrika Trust (1995) 212 ITR 456 (Ker)***

d. ***Governing Body of Rangaray Medical College vs. Income Tax Officer, A-ward, Circle-I, Kakinada (1979) 117 ITR 284 (AP)***

4.12 *Whether treatment of in-patients is a necessary condition to claim exemption?*

No. This position was upheld in the case of ***Mangilal Gotawat Charitable Trust vs. Commissioner of Income Tax, Karnataka (1984) 150 ITR 0682 (Kar).***

4.13 *Whether a dispensary will qualify as other institutions to claim exemption?*

If there is reception and treatment of persons suffering from illness if they solely exist for philanthropic purposes and not

for the purposes of profit. This position was upheld in the case of trustees of ***Sarvajanik Chikitsalaya Trust vs. Seventh Income Tax Officer (1984) 020 TTJ 0005 (Mum-Trib).***

4.14 Whether utilizing funds for establishing other health care is an application?

Held yes in the case of ***CIT vs. Economic and Entrepreneurship Development Foundation (1991) 188 ITR 540 (Cal).***

4.15 Whether hospital or other institutions can carry on incidental business and can claim exemption?

In case a hospital or other institution exists solely for philanthropic purposes, even if incidentally profits are earned, it is entitled to claim exemption. The seventh proviso to sec. 10(23C) permits an incidental business activity for the attainment of main objects of education, provided separate books of accounts are maintained. This proviso will apply only in case of approval by the prescribed authority as per cl. 10(23c)(vi) and (via).

4.16 What is the position when other objects are not incidental?

One of the criteria for exemption is that hospital or other institutions exists for reception and treatment of persons suffering from illness.th can be verified from the object of the trust. if it has other objects, then it is not entitled to claim exemption under this clause. This principle was upheld in the case of ***Aurora Educational society vs. Chief CIT & ors. (2011) 339 ITR 323 (AP)***

4.17 Whether registration under section 12A is required to claim exemption under section 10(23C)?

In case of trusts or institutions that are covered under sec 10(23C), Sec. 11 will not apply; therefore, it is not necessary for these institutions to get registered under Sec. 12A.

4.18 Whether exemption under section 10(23C) has to be evaluated every year?

It is incumbent upon the department to examine that the conditions imposed in Sec. 10(23C) are satisfied .To satisfy this it is necessary to verify the eligibility each year. this position was affirmed by the Apex Court in the case of ***American Hotel & Lodging Association Educational Institute vs. CBDT & Ors (2008) 301 ITR 0086 (SC).*** Similarly held in the case of ***Vanita Vishram Trust vs. Chief CIT & ORS (2010) 327 ITR 121 (Bum).***

4.19 Whether diversion of funds to specified persons can be a ground to reject exemption?

In case of sec. 11, where s 13 applies exemption may be denied. However, in case of sec. 10(23C)(vi) and via), 13 will not apply. However as per thirteenth proviso read with third proviso to sec. 10(23C), income has to applied wholly and exclusively for the objects for which it is established. If not exemption may not be allowed. Likewise application for seeking approval may be rejected.

4.20 Whether deficit of earlier years can be carried forward for set off in case of hospital or other institutions

The deficit can be carried forward and set of during subsequent years and it will be deemed aas application of income as held in the case of ***CIT vs. The Trustees of seth Mewanjee Framy's Pandey Charitable Fund Trust, Pandey Sanitorium, Bombay (2003)177 taxation 19 (Bom)*** and ***CIT vs. Institution of Banking Personnel Selection (IBPS)(2003)64 ITR 110 (Bom)*** with reference to s 11 of the Income Tax Act, 1961.

However, held no in the cases of ***CIT vs. Lallu Bhai Gordhandas Mehta Charitable Trust (1994) 207 ITR 0104(Guj)*** and ***Commissioner of Income Tax vs. Mukul***

Jain Medical institute (1990) 183 ITR 89 (Del)

Recently Supreme Court has dismissed the SLP of the Income tax department against the C/F of excess spending (Deficit) in the case of ***DCIT (Exp) Delhi vs. Subros Educational Society vide ITA No. 6240/DEL/2016 dt. 09.11.2017.*** Therefore now it is a settled law that deficit of earlier years is allowable to set off against the current years income and the excess spending (deficit) of current year is also allowable to be carried forward and adjusted against the future income.

5. Provisos to Section 10(23C)

There are presently total 20 provisos to section 10(23C) and certain provisos are become redundant nevertheless other provisos are very important

First Proviso – The organizations referred to in sub clauses iv to via shall make an application in prescribed form to prescribed authority for the purpose of grant of exemption or continuance thereof.

Second Proviso – The prescribed authority before granting approval may call for such documents or information as its think necessary in order to satisfy itself about the genuineness of the activities and the compliance of such requirements under any other law for the time being in force as are material for the purpose of achieving its objects and it may also make such inquiries as it deems fit. (The said compliance under any other law is added w.e.f. 01-09-2019)

Third Proviso – The organizations referred to in sub clauses iv to via –

a) Applies its income and accumulates it for application, wholly and exclusively to the objects for which it is established and in a case where more than 15% of its income is accumulated on or after 1-4-2002 the period of accumulation, of the amount exceeding 15% of its income, shall in no case exceed five years and,

b) does not invest or deposit its funds other then-

   i) any assets held by such organizations where such assets form part of the corpus of such organization as on 1-6-1973,

   ia) any asset , being equity shares of a public company, held by such organization where such assets form part of the corpus such organization as on 1-6-1998,

   ii) any asset being debentures issued by or on behalf of any company or corporation, acquired by such organization before the 1-3-1983,

   iii) any accretion to the shares forming part of the corpus mentioned in sub clause (i) and (ia) by way of bonus shares allotted to such organization,

   iv) Voluntary contributions received and maintained in the form of Jewellery, furniture or any other article as the Board may by official notification in the official Gazette specify, for any period during the previous year otherwise then in any one or more of the forms or modes specify in sub section 11(5).

Fourth Proviso – The exemption under sub clause (iv) & (v) shall not be denied if the funds are invested before 1-4-1989 otherwise then permitted modes u/s.11(5) if such funds do not continue to remain so invested after 30-3-1993.

Fifth Proviso- The exemption under sub clause (vi) & (via) shall not be denied if

the funds are invested before 1-6-1998 otherwise then permitted modes u/s.11(5) if such funds do not continue to remain so invested after 30-3- 2001.

Sixth Proviso – The exemption under sub clause (iv) to (via) shall not be denied if voluntary contribution other than cash or of the nature referred to in clause (b) of the third proviso subject to the condition that such contributions are not held by the organization otherwise then in one or more modes specified in Sec. 11(5) after the expiry of one year from the end of the previous year in which such asset is acquired or 31-3-1992 whichever is later.

Seventh Proviso – Nothing contain in sub clause (iv) to (via) shall apply in relation to any income of the organization, being profits and gains of business, unless the business is incidental to the attainment of its objectives and separate books of accounts are maintained by it in respect of such business.

Eighth Proviso – Any notification issued by Central Govt. under sub clause (iv) or (vi) before the date of on which the taxation laws (Amendment) Bill 2006 received assent of the president, shall at any one time, have effect for such assessment year or years, not exceeding three assessment years, including an assessment year or years commencing before the date on which such notification is issued, as may be specified in the notification.

Ninth Proviso – Where an application under the first proviso is made under sub clause (iv) to (via) shall be granted or rejected within the period of twelve months from the end of the month in which such application is received.

Tenth Proviso – Where the total income of such organisations referred to in sub clauses (iv) to (via) exceeds the maximum amount not chargeable to tax without giving effect to provisions of the said sub clauses, such organization shall get its accounts audited in respect of that year and furnish along with the return of income. The prescribe form of such audit report is Form 10BB.

Eleventh Proviso – The amount of donation received by the fund or institution in the terms of clause (d) of sub section (2) of section 80G in respect of which accounts of income and expenditure have not been rendered to the prescribed authority under clause (v) of sub section (5C) of that section, in the manner specified in that clause or which has been utilized for the purposes other than providing relief to victims of earthquake in Gujarat or which remains unutilized and not transferred to PM National Relief Fund on or before 31.03.2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

Twelfth Proviso – Any amount credited or paid out of the income of such organisations referred to in sub clauses (iv) to (via) to any trust or institution registered u/s. 12AA as corpus donation shall not be treated as application of income.

Thirteenth Proviso – That for the purpose of determining the application under item (a) of third proviso the provisions of section 40(a)(ia) and section 40A(3) and (3A) shall mutatis mutandis, apply as they apply in computing the income chargeable under the head profits and gains of business or professions.

Fourteenth Proviso – Provided also that where such organisations referred to in sub-clauses (iv) to (via) does not apply its income during the year of receipt and accumulates it, any payment or credit out of such accumulation to any trust or institution registered u/s. 12AA or to

any such organisations referred to in sub clauses (iv) to (via) shall not be treated as application of income.

Fifteenth Proviso – Where the fund or institution referred to in sub clause (iv) to (via) is notified by Central Govt. or is approved by prescribed authority and subsequently the government or the prescribed authority is satisfied that such organizations has not applied its income in accordance with the provisions contained in clause (a) of third proviso or invested or deposited its fund in accordance with the provisions contained in sub clause (b) of third proviso or the activities of such organisations are not genuine or are not being carried out in accordance with all or any of the conditions subject to which it was notified or approved or such organisations have not complied with the requirement of any other law for the time being in force, and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality. It may, at any time after giving a reasonable opportunity of showing cause against the proposed action to the concerned such institutions rescind the notification or, by order, withdraw the approval, as the case may be, and forward a copy of the order rescinding the notification or withdrawing the approval to such institutions and to the Assessing Officer.

Sixteenth Proviso – In case of such organisations referred to in the first proviso makes an application on or after the 1st June, 2006 for the purposes of grant of exemption or continuance thereof, such application shall be made on or before 30th September of the relevant assessment year from which the exemption is sought.

Seventieth Proviso –Any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income of such organisations.

Eighteenth Proviso –All pending applications for approval under sub clause (iv) and (v) before the 1st June, 2007, shall stand transferred on that day to the prescribed authority.

Nineteenth Proviso –The income of such organisations referred to in sub clause (iv) or (v) shall be included in its total income if the provisions of the first proviso to section 2(15) becomes applicable, whether or not any approval granted or notification issued.

Twentieth Proviso –Where such organisations referred to in sub clause (iv) (v) (vi) & (via) has been approved by the prescribed authority, and the notification or the approval is in force in any previous year, then, nothing contained in any other provision of this section other than clause (1) thereof, shall operate to exclude any income received on behalf of such organisations, from the total income of the person in receipt thereof for that previous year.

Explanation – In this clause, where any income is required to be applied or accumulated, than for such purpose the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, claimed as an application of income under this clause in the current year or any previous year.

(The readers may please note that there are some FAQs commonly applicable to both the educational and medical organizations and for the purpose of brevity it is mentioned "such organizations" which represents for university and other educational institutions and hospital and other medical institutions.)

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Registration of Trust under the Income-tax Act

CA Paras K. Savla

1.0 Background

Any income derived from the property held under trust or institution set up wholly for charitable or religious purposes is not chargeable to tax subject to fulfilment of certain conditions. One of the condition is that such trust or institution is required to be registered under the provisions of Income-tax Act 1961 ('the Act') and rules made thereunder. The registration so granted does not extend any exemption to an institution under section 11, except to the fact that such registration is mandatory for claiming an exemption under section 11. The registration under section 12AA is only *fait accompli* to the objects of the institution[1]. An institute, though registered under section 12AA, would still be taxed on the income which has not been applied in accordance with section 11, or in respect of which section 13 comes into play. The registration itself would be sufficient proof of the fact that the trust or institution concerned was created or established for charitable or religious purpose[2]. The purpose of registration under section 12AA of the Act, only the objects of the trust were charitable or not was to be seen and at the stage of grant of registration by the Commissioner of Income Tax, the application of the income is not to be looked in[3].

In July 2018, Public Accounts Committee (PAC) in their 104th Report on the Action Taken by the Government on the observations/recommendations of the Committee contained in their 27th Report (16th Lok Sabha) on 'Exemptions to Charitable Trusts and Institutions' *inter alia* expressed their concern that public charitable trusts were being used to run commercially for profit business and had repeatedly violated provisions of the Income-tax Act. The Committee was concerned over the serious nature of all the violations and failure of the ITD to monitor whether the trusts were fulfilling the objectives under which they have been established and also ensuring that there is

1. *ACIT vs. Surat City Gymkhana [2008] 300 ITR 214 (SC)*
2. *CIT vs. Ootacamund Gymkhana Club [1977] 110 ITR 392 (Mad)*
3. *Fifth Generation Education Society vs. CIT [1991] 54 Taxman 237 (All)*

no abuse of the concession enjoyed by such trusts[4]. It seems that various amendments are being carried relating to the taxation of charitable or religious trust or institution keeping this in background.

2.0 Applicable Section, Rule and Form

- Section 12AA provides a procedure for registration of the trust or institution.
- Rule 17A (as modified w.e.f. 19-2-2018) provides that application be made in Form 10A along with specified documents.

3.0 Application

3.1 Rule 17A provides that the application for registration should be made in Form No. 10A along with the following applicable documents:

- Self-certified copy of the instrument creating the trust or establishing the institution e.g., Trust deed in case of Trust, Memorandum and Rules and Regulations in case of Society, Memorandum and Articles of Association in case of not of profit Company and in case it is created otherwise than under an instrument, self-certified copy of the document evidencing the creation of the trust, or establishment of the institution;
- Self-certified copy of registration certificate issued by regulatory authorities e.g., Charity Commissioner or Registrar of Companies or Registrar of Firms and Societies or Registrar of Public Trusts etc. as applicable;
- Self-certified copy of the documents evidencing adoption or modification of the objects, if any;
- In case the trust or institution has been in existence during any year or years prior to the financial year in which the application for registration is made, self-certified copies of the annual accounts of the trust or institution relating to such prior year or years (not exceeding three years immediately preceding the year in which the said application is made) for which such accounts have been made up;
- Note on the activities of the trust or institution;
- Self-certified copy of existing order granting registration under section 12A or section 12AA, as the case may be;
- Self-certified copy of the order of rejection of application for grant of registration under section 12A or section 12AA, as the case may be, if any.

3.2 Application is required to be furnished electronically and verified either through digital signature or through electronic verification code by the person who is authorised to verify the return of income under section 140 of the Act.

4.0 Procedure for registration

4.1 The Principal Commissioner or Commissioner, on receipt of an application for registration of a trust or institution, shall–

- Call for such documents or information from the trust or institution as he thinks necessary in

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order to satisfy himself about,–

(i) the genuineness of activities of the trust or institution; and

(ii) the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects,

and may also make such inquiries as he may deem necessary in this behalf;

- After satisfying himself about the objects of the trust or institution and the genuineness of its activities, he shall pass an order in writing registering the trust or institution or if not so satisfied, pass an order in writing refusing to register the trust or institution.
- It shall be passed before the expiry of six months from the end of the month in which the application was received.

4.2 Usually the following information is called by the PCIT/CIT:

- A declaration that no part of the income of the Trust/Society/Non Profit Company used directly or indirectly for the benefit of any person specified in section 13(1)(c) of the Act and that no part of the income or property of the Trust/Society/Company was ever used or applied for the benefit of any person specified in section 13(1)(c) of the Act, duly signed by the Authorized Signatory.
- A note specifying the main area of your charitable/religious activities and a projection/plan for the main charitable/religious activities to be undertaken in the next two years.
    - o Asking about charitable activities at the nascent stage would amount to putting a cart before the horse[5].
- 'No Objection Certificate' from the owner of the premises from where it is operating along with proof of his ownership.
- A certified copy of annual accounts since inception/during the last three years and also year to date.
- A certified copy of the Trust Deed/ Memorandum of Association and produce original copy for verification.
    - o A copy is required to be certified from the regulatory authority under which it is registered e.g. Registrar of Companies in case it is a company registered under section 8 of Companies Act.
- A copy of the proof of identity of the main Trustee/President or Secretary of the Trust/Society/Non-Profit Company.
- A note on activities conducted since inception/during the last three years.
- Details of donations made since inception/during the last three years.
    - o Where the trust existence for several years and had not made

5. *CIT vs. Vijay Vargiya Vani Charitable Trust [2015] 58 taxmann.com 335 (Rajasthan)*

an application in past years cannot be the reason for the rejection of application[6].

- Details of donations received, including corpus donation, received since inception/during the last three years.
- Details of bank accounts including the name of the bank, branch, type of account and number of account.
- An undertaking that there will be no infringement to the 1st proviso to section 2(15) of the Income-tax Act, 1961.
- Specify the category of charitable purposes provided in section 2(15) of the Income-tax Act, 1961 in which your case falls, i.e., whether objective is relief of the poor/education/yoga/medical relief/preservation of environment (including watersheds, forests and wildlife)/preservation of monuments or places of artistic/historic interest/advancement of any other object of general public utility/religious activities.
- Trust Deed/Memorandum of Association should include mandatory clauses viz., trust is irrevocable, beneficiaries are a section of the public and not specific individuals, in the event of dissolution of Trust/Society/Non Profit Company the funds/assets of the Trust/Society/Non-Profit Company will be transferred only to some other Trust/Society/Non Profit Company having similar objectives. If such clauses are not there in constitution documents include them in Trust Deed/Memorandum of Association and file a certified copy of the amended Trust Deed/Memorandum of Association.

  o Section 12AA does not say that any mandatory clause has to be incorporated in the bye-laws or any other constitutional documents. Registration cannot be rejected on the ground that the mandatory clause is absent[7]. The "dissolution clause" and/or any provision for distribution of the properties in the event of closure/dissolution of the trust cannot be the ground for refusal for registration[8].

4.3 From 1st September, 2019 registering authority besides satisfying itself about the genuineness of activities is also required to satisfy himself that such trust or institution has complied with the requirements of any other applicable law which are material for the purpose of achieving its objects.

4.3.1. ***Genuineness of activities:*** The genuineness of the objects and activities of the Trust has to be tested at the time of registration[9]. Examination of the genuineness of the activities would mean to see that the activities are not by way of camouflage or bogus or artificial and whether these are in accordance with the objects of the institution. The scope of such enquiry does not extend beyond that point. The exemption under section 11 can be availed of by institutions which are genuinely

6. *CIT vs. Shri Advait Ashram Society [2012] 28 taxmann.com 18 (All.)*
7. *Kasargod District Health & Family Welfare Society Kanhangad vs. CIT [2014] 49 taxmann.com 333 (Cochin-Trib.)*
8. *CIT vs. Tapagachha Sangh Mota [2015] 59 taxmann.com 204 (Gujarat)*
9. *CIT vs. R. S. Bajaj Society [2014] 42 taxmann.com 573 (All.)*

engaged in 'charitable activities'. The genuineness of the purpose gets tested by the obligation created to spend the income exclusively or essentially on charity, i.e., it's charitable objects. The profit-making, or running the school on business or commercial principles, would not exclude it from being regarded as existing for a charitable purpose[10].

- The Commissioner has to satisfy himself about the objectives of the trust and the genuineness of its activities. For such purpose, he has the power to call for such documents or information from the trust as he thinks are necessary. However, this does not mean that if the activities of the trust have not commenced, the Commissioner has authority to reject its application for registration on the ground that the Trust failed to convince him about the genuineness of the activities. It is, of course, true that even if the activities of the trust have not commenced, if the Commissioner has sufficient material in his command, he may still come to the conclusion that he is not satisfied about the objectives of the Trust or the genuineness of its activities[11].
- The provision under section 12AA of the Income-tax Act does not stipulate such a condition about commencing the activity for grant of registration.
- Section 12AA(1) contemplates satisfaction of the Commissioner about the objects of the trust and the genuineness of the activities and make such enquiry as may be necessary for the purpose of grant of registration. Considering the fact that the continuance of registration is further a subject matter of scrutiny by the Commissioner as contemplated under section 12AA(3) of the Act, the Revenue would not be justified in refusing the registration at the threshold[12].
- The object of Section 12AA is to examine the genuineness of the objects of the trust but not the income of the trust for charitable or religious purpose. The Trust can move the application immediately at the time of formation then there is no prohibition under the Act seeking registration. Asking about charitable activities at the nascent stage would amount to putting a cart before the horse[13].
- The power of the Commissioner to look into the objects of the Society and the genuineness of the same cannot be doubted when the basis is of non-supply of information[14].
- The assessee-trust, running a children home after getting compulsory registration from Directorate of Social Defence of State of Tamil Nadu under Juvenile Justice (Care and protection of children) Act, 2015, its genuineness could not be doubted[15].

10. *Lord Shiva Educational Welfare Society vs. CIT(E) [2018] 97 taxmann.com 501 (Amritsar - Trib.)*
11. *CIT vs. Kutchi Dasa Oswal Moto Pariwar Ambama Trust [2013] 29 taxmann.com 228 (Gujarat); Hardayal Charitable & Educational Trust vs. CIT [2013] 32 taxmann.com 341 (Allahabad)*
12. *DIT (Exemption) vs. Seervi Samaj Tambaram Trust [2014] 362 ITR 199 (Mad.)*
13. *CIT vs. Vijay Vargiya Vani Charitable Trust [2015] 58 taxmann.com 335 (Rajasthan)*
14. *CIT vs. Sri Guru Gorakh Nath Charitable Educational Society [2015] 60 taxmann.com 56 (Punjab & Haryana)*
15. *Hosanna Ministries vs. ITO(E) [2017] 80 taxmann.com 173 (Madras)*

- 71% of the receipts of the Trust are being spent in accordance with its objects. Therefore, this itself would establish that the trust is in existence. A partial expenditure which is not authorized by the trust would not by itself lead to the trust becoming non-genuine. The consequence would be that the benefit of Section 11 of the Act will not be available to that extent. At the stage of registration, this issue is premature[16].

- The object of Section 12AA of the Act is to examine the genuineness of the objects of the trust and though while examining genuineness, the income, as well as resources of the trust, may be taken into consideration but any suspicion as to these facts cannot be the sole criteria for rejecting an application under Section 12A of the Act. If a trustee is a life-long member of a trust, it automatically does not raises an inference that the trust is not charitable. The fact that a trustee is a life member, may be relevant but cannot by itself lead to a finding that the trust is not charitable[17].

- When a trust is created for the purpose of carrying out CSR activities, the registration under section 12AA of the Income-tax Act, 1961 cannot be denied. *Vide* notifications dated 27-2-2014 the ministry of Corporate Affairs in the rules framed for the purpose of CSR has implicitly provided for forming the dedicated trust under sub-rule 2 to rule 4[18].

- The application under Section 12A of the Act cannot be rejected merely on the ground that the Secretary of the Society was getting lease rent for the land given to the Society for running the School or his wife who had requisite qualification was teaching in the school and was being paid the salary[19].

- The only duty of the Commissioner of Income-tax was to satisfy himself about the genuineness of the activities of the trust or institution and not about the credential, capacity, qualification, etc of the trustee[20].

Genuineness has been doubted

- The assessee society was registered with Registrar of Societies but no activity had been started up to the date of present proceedings. It was also observed that some of the objects are not genuine. In the absence of the commencement of activities there was no material to verify the objects and activities of the society and their genuineness[21].

- While granting registration to a trust, authorities is empowered to examine only genuineness of trust and its activities and that only during assessment eligibility in terms of sections 10, 11 and 12 is to be

16. *CIT(E) vs. Manekji Mota Charitable Trust [2019] 109 taxmann.com 258 (Bombay)*
17. *CIT vs. Baba Kartar Singh Dukki Educational Trust [2014] 42 taxmann.com 17 (Punjab & Haryana)*
18. *Nanak Chand Jain Charitable Trust vs. CIT(E) [2018] 91 taxmann.com 197 (Delhi-Trib.)*
19. *CIT(E) vs. Ambala Public Educational Society [2018] 100 taxmann.com 131 (Punjab & Haryana)*
20. *Prayer for India vs. ITO [2012] 20 taxmann.com 359 (Chennai)*
21. *Suchinta Educational Society vs. CIT [2013] 35 taxmann.com 178 (Chandigarh-Trib.)*

verified as to whether or not what was professed in Deed of trust. SLP has granted against the High Court's ruling[22].

- The list of donors showed that the only names are mentioned without any address. The lack of information in respect of parentage, age, address or PAN Numbers in the list of donors are the good reasons for declining the registration of the assessee as a charitable trust[23].

4.3.2 Let us examine the requirement of the phrase *"the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects, and may also make such inquiries as he may deem necessary in this behalf"*.

- Whether trust or institution is required to comply with each every requirement even if it is trivial or procedural, of such identified law or not? The expression is followed by the word 'material for the purpose of achieving its object'. The material mean of such consequences, importance or significance as to be likely to influence the determination of a cause; to alter the character of an instrument, etc.[24]. The Hon'ble FM in her budget speech has said that "In order to ensure that trust or institution complies with local laws that are material for the purpose of achieving its objects…". Hence view can be formed that the requirements have to be material and that also for achieving the objects are required to have complied.

- The amendment has been termed in the Memorandum as "anti-abuse measure". The trust or institution is required to comply with any State or Central Law, Rules under a statute and Notifications issued under a Law e.g. Maharashtra Public Trust Act 1950, Societies Registration Act 1860, Foreign Contribution Regulation Act, 2010 etc. and Rules made under those Acts. The expression *"any other laws"* will not include Income-tax Act 1961.

- In past it was held that compliance of Rights to Education Act[25], Education institution run without obtaining requisite permission[26], Society is not registered under a particular State statute[27], charging excess fees in violation of fee prescribed by the Government[28], some part of land on which a university setup was not owned as per certain Government notification[29], etc., are not relevant while grant of registration, so long as objects are charitable in nature. But post amendment registering authority

22. *CIT vs. Sree Anjaneya Medical [2016] 74 taxmann.com 243 (SC)*
23. *CIT vs. Savior Charitable Trust [2013] 35 taxmann.com 295 (Punjab & Haryana)*
24. Legal Glossary 2015 by Govt. of India, page No. 258
25. *CIT(E) vs. Kids-R-Kids International Education & Social Welfare Trust [2018] 99 taxmann.com 384 (Punjab & Haryana); Shri Gian Ganga Vocational & Educational Society vs. CIT [2013] 35 taxmann.com 17 (Delhi-Trib.)*
26. *Shri Krishna Education & Welfare Trust vs. CIT [2009] 27 SOT 331 (Delhi-Trib.)*
27. *CIT(E) vs. Ambala Public Educational Society [2018] 100 taxmann.com 131 (Punj. & Har.)*
28. *R. K. Educational Society vs. CIT [2015] 56 taxmann.com 154 (Visakha.-Trib.)*
29. *Indian Medical Trust vs. PCIT [2018] 99 taxmann.com 273 (Jaipur-Trib.)*

is required to satisfy himself about the compliance with other statutes which are material for the purpose of achieving its objects.

- Trust or institution may have multiple objects. Some of the object may not be perused immediately. Non-compliance of certain laws relating such objects may not be a hindrance for grant of registration. Especially when Registering Authority has been granted with power to cancel registration when the trust or institution has not complied with the requirement of any other law. If Trust or Institution hasn't started the activity then the requirement should be deemed to be complied with and the registering authority ought to be considered as satisfied with the genuineness of activities[30].

5.0 Cancellation of Registration

5.1 Where a trust or an institution has been granted registration u/s. 12AA or 12A and subsequently the Principal Commissioner or Commissioner can cancel the registration of such trust or institution by an order in writing, if

- Section 12AA(3) – he is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, after giving a reasonable opportunity of being heard; or
- Section 12AA(4) - w.e.f. 1-9-2019 notices that
  - o the activities of the trust or the institution are being carried out in a manner that the provisions of sections 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of section 13(1), or
  - o the trust or institution has not complied with the requirement of any other law as specified u/s. 12AA(1)(a)(ii), and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.
- However under 12AA(4) registration shall not be cancelled, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner.

5.2 Section 12AA(3)

- The objects and activities of the trust or institution are genuine registration cannot be cancelled merely because receipts are exceeding threshold limit as provided under the second proviso to section 2(15) of the Act. It is open to the Assessing Officer to deny exemption under section 11 on the receipts of the assessee[31].
- There is distinction between objects and the power to carry out those

30. *Hardayal Charitable & Educational Trust vs. CIT [2013] 32 taxmann.com 341 (All.); DIT vs. Foundation of Ophthalmic and Optometry Research Education Centre [2012] 25 taxmann.com 376 (Delhi)*
31. *Vanita Samaj vs. DIT(E) [2014] 45 taxmann.com 303 (Mumbai-Trib.); SAE India vs. DIT(E) [2014] 52 taxmann.com 209 (Chennai-Trib.)*

objects. The amendment made in the Trust Deed not even remotely suggest any change/addition to the objects of the Trust. It has only to do with the appointment of the Chief Trustee and the manner of managing the Trust. Hence cancelling registration under section 12AA is not justified[32].

- The registration of assessee trust under section 12AA was cancelled for receiving a bogus donation but High Court by impugned order restored registration holding that one bogus donation would not establish that activities of trust were not genuine. Apex Court held that the reason assigned by High Court was erroneous and ran contrary to plain language of section 12AA(3) and, therefore, order of High Court was to be set aside and matter was remanded to Commissioner (Exemptions) for consideration on merits[33].

5.3 Section 12AA(4)

- Sub-section (4) has been amended w.e.f. 1-9-2019. It now provides for the cancellation of registration under 2 circumstances. First – due of operation of section 13(1) trust or institution is not entitled to the benefit of section 11 or 12 on whole or part of its income. Second – due non-compliance of any other law order etc. has been passed to that effect. The second limb is added with w.e.f. 1-9-2019

- Section 13(1) provides that nothing contained in section 11 or 12 will not apply in the following circumstances:

  o any part of the income from the property held under a trust for private religious purposes which does not ensure for the benefit of the public;

  o a charitable trust or a charitable institution created or established for the benefit of any particular religious community or caste;

  o a trust established for charitable or religious purposes or a charitable or religious institution, has applied it's any income directly or indirectly for the benefit of any related person specified in section 13(3);

  o a trust established for charitable or religious purposes or a charitable or religious institution, invests in investments which are not in accordance with section 11(5).

- Cancellation of registration under section 12AA(4) may not arise in every situation when trust or institution does not comply with requirements of any other law. It needs to be read with requirements as specified u/s. 12AA(1)(a)(ii) i.e. the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects. The authority may not be required to independently examine compliance with the requirements. His role is limited to satisfy himself that the requirement which is not complied with, and in respect of

32. *CIT(E) vs. Sadguru Narendra Maharaj Sansthan [2018] 92 taxmann.com 405 (Bombay)*
33. *CIT(E) vs. Jagannath Gupta Family Trust [2019] 102 taxmann.com 34 (SC)*

which order, direction or decree, etc., is received and whether it is material for achieving the objects or not.

- On the occurrence of specified event under sub-section (4) is it mandatory for the PCIT or CIT to cancel the registration? It is provided "... *then, the Principal Commissioner or the Commissioner may, by an order in writing, cancel ...*". Word 'may' shows such cancellation is discretionary and not mandatory. Cancellation is not automatic. Support can be drawn from section 271(1)(c), which also uses word may for levy of concealment penalty. Courts have held that levy of penalty is not automatic at its discretion. Further section 12AA(3) uses language "....he shall pass an order in writing cancelling the registration....", word 'shall' has been used in contrast to word 'may' under section 12AA(4). Two consecutive provisions under sub-section (3) & (4) two different words have been used and hence word 'may' should not be read as 'shall' under sub-section (4). Hence PCIT/CIT has to exercise his discretion considering the facts and circumstances of the case.

- Under section 12AA(3) it is specifically provided that order for cancellation shall be passed after providing a reasonable opportunity of being heard. However, no such express provision is made under section 12AA(4). Considering principle of natural justice trust or institution need to be provided an opportunity of being heard before any penal action is taken against it. Supreme Court in Sahara India (Firm) has held that that the assessee should get a reasonable opportunity of being heard and show cause, even if the statute does not expressly so provide[34]. Further such order need to be speaking order after considering representation of the trust or institution. The object of natural justice is to ensure that parties views/objections are taken on board and considered before it is rejected. The requirement of natural justice is only to ensure that the party's stand is effectively dealt with by the authorities under the Act. Mere ritualistic giving of hearing and reproducing the submissions made without understanding the party's case would not satisfy the test of natural justice[35].

- Whether the power of cancellation will apply to the defaults that occurred prior to 1-9-2019. Power of cancellation under sub-section (4) (second limb) is w.e.f. 1-9-2019. Cancellation is a penal provision. It cannot be applied retrospectively unless specified accordingly. Hence in respect to defaults occurred prior to 1-09-2019 and order etc. passed whether prior to 1-9-2019 or thereafter should not trigger vigour of this sub-section.

Consequences of the cancellation

On cancellation of the registration various tax incidence may occur on charitable or religious trust or institution, the person giving donation

34. *Sahara India (Firm) vs. CIT [2008] 169 Taxman 328 (SC)*
35. *TLG India (P.) Ltd. vs. DCIT [2019] 111 taxmann.com 376 (Bombay)*

to such charitable or religious trust or institution, person receiving assistance from such charitable or religious trust or institution.

Implication on charitable or religious trust or institution

- Such charitable or religious trust or institution may be subject to exit tax under section 115 TD.
- On losing registration trust or institution would become entitled to the exemption u/s 10 which it was otherwise not entitled by virtue of provisions of section 11(7).

Implication on a donor to charitable or religious trust or institution

- The donor is entitled to the deduction under section 80G if such trust or institution's income is not taxable by virtue of provisions of section 11 or 12. In case registration under section 12AA is cancelled, income would be subject to taxation and hence donor would not be entitled to deduction under section 80G for the donation provided to such trust or institution.

Implication on beneficiary receiving donation form charitable or religious trust or institution

- Any money or property exceeding ₹ 50,000, received without consideration or consideration less than market consideration from the charitable institution registered under section 12A or 12AA shall not be included in the total income of the recipient. In case registration is cancelled, receiver or donee would be liable to pay tax on such money or property received from such trust or institution.

Exit Tax 115TD (Applicable from 1-6-2016)

Section 115 TD provides that if -

- the registration granted to trust or institution under section 12AA has been cancelled or
- trust or institution has adopted or undertaken modification of its objects which do not conform to the conditions of registration and it has not applied for fresh registration under section 12AA in the said previous year or has filed an application for fresh registration under section 12AA but the said application has been rejected

then, in addition to the income-tax chargeable in respect of the total income of such trust or institution, the accreted income of the trust or the institution as on the specified date shall be charged to tax and such trust or institution, as the case may be, shall be liable to pay additional income-tax at the maximum marginal rate on the accreted income.

The accreted income means the amount by which the aggregate fair market value of the total assets of the trust or the institution, as on the specified date, exceeds the total liability of such trust or institution computed in accordance with the method of valuation as prescribed under Rule 17CB. However, this will not apply to the assets acquired out of agricultural income or acquired out of income which was not entitled to exemption under section 11 or 12.

Surrender of registration

Can charitable or religious trust or institution surrender it registration granted under section 12A or 12AA voluntarily? If such trust or institution surrenders its registration especially before the introduction of Section 115 TD – Exit Tax w.e.f. 1-6-2016, can it avoid rigours of Exit Tax?

CAG in its Report No. 9 of 2019 of the Comptroller and Auditor General of India for the year ended March 2018, Page 101 has made following observations-

"6.6.2 As per proviso (i) and (ia) to section 13(1)(d)(iii), provisions of section 13(1)(d)(iii) shall not apply to any assets held by trust where such assets form part of the corpus of the trust as on 1-6-1973 or any accretion to the shares, forming part of the corpus by way of bonus shares allotted to the trust.

In CIT(E), Mumbai charge, three trusts continued to hold an investment in modes other than those prescribed under section 11(5). These trusts held collectively 55.55 per cent of shares (2,24,478 shares valuing ₹ 76.90 lakh) in a group company as on 31-3-2014 which were invested prior to June 1973. Audit noticed that there is nothing on record to show that the investments were made from corpus/ income of these trusts as on 1-6-1973 or before.

The corpus fund of the trusts is being utilized to control the business of the group companies by holding majority stake in a group company, instead of applying funds for charitable purpose. Therefore, the continuity of exemption provisions for investment by such trusts prior to 1.6.1973 needs to be reviewed. The reply of the Ministry was awaited."

It also recommended *"…CBDT may consider bringing in a level playing field by inserting a sunset clause for such provisions applicable to those trusts that have retained the benefit on ground of actions, having been taken earlier though these are prohibited now. A sunset clause for such provisions would ensure that benefits not available now are not available to anyone, and thus that all types of trusts and institutions are treated on similar lines….."*

It seems that these observations and recommendation are made considering the activities of the various Tata Trusts. Similar observations were also made in 2013. From various press reports it is understood Tata Trust has voluntarily surrendered its registration in 2015. But during October 2019 income-tax department has cancelled registration of various Tata trusts. Tata Trust has also issued press release in this regards on November 1, 2019. Seems that there is going to be long battle between the Tata trusts and income-tax department.

Considering various adverse consequences trust or institution should take informed decision whether to obtain registration under section 12AA or not?

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> Where do the evils like corruption arise from? It comes from the never-ending greed. The fight for corruption-free ethical society will have to be fought against this greed and replace it with 'what can I give' spirit.
>
> *– A. P. J. Abdul Kalam*

Registration under section 80G of Income-tax Act

CA Paras K. Savla & CA Prity Dharod

Background

In order to claim deduction under section 80G of the Income-tax Act, 1961 ('the Act') by the donor, Charitable Trust or Institution is required to obtain registration under section 80G. The advantage institution or trust registration confers is that the donor will no longer be taxed on that portion of income which is donated to the charitable trust or institution. It also effectively enables a donor to not just feel good about making a donation for a cause but also reap the tax advantage of lowering taxable income associated with it. Besides tax advantage enjoyed by the donor, registration under section 80G also helps the charitable organisation to obtain government funding, CSR funds, FCRA registration etc. While the registration process may take a few months, it is a lifetime registration with no requirement for renewals. Donor giving donation exceeding ₹ 2,000 can claim a deduction, only if, such donation is paid in any mode other than cash.

Applicable Section, Rule & Form

- Section 80G(5)(vi)
- Rule 11AA
- Form 10G

Prerequisite for registration

Application for a certificate under Section 80G can be done only by charitable trusts or institutions and not by religious trusts or institutions and established in India for a charitable purpose. The application can be made along with the application under section 12AA. However, it is experienced that even though both applications are made simultaneously, but both applications are not disposed of simultaneously. When the assessee trust is registered as a charitable institution under Section 12AA of the Act. The natural corollary is that this application under Section 80G(5) of the Act also becomes liable to be allowed[1].

1. *CIT vs. Lok Sewa Sansthan Samiti Sonebhadra [2019] 105 taxmann.com 202 (All.); Revenues SLP was dismissed [2019] 105 taxmann.com 203 (SC)*

Upon registration donee is entitled to the deduction on donation as referred under sub-clause (iv) of clause (a) of sub-section (2) of section 80G which refers "any other fund or any institution to which this section applies". In order to obtain registration the institution is required to fulfil the following conditions:

- the institution or fund derives any income which is not liable to inclusion in its total income under the provisions of sections 11 and 12 or clause (23AA) or clause (23C) of section 10. However, this condition is not applicable to the business income provided -
  - o separate books of account in respect of such business are maintained
  - o the donations received by the institution or fund are not used by it, directly or indirectly, for the purposes of such business
  - o the institution or fund issues to a person making the donation a certificate to the effect that it maintains separate books of account in respect of such business and that the donations received by it will not be used, directly or indirectly, for the purposes of such business;
- the instrument under which the institution or fund is constituted does not, or the rules governing the institution or fund do not contain any provision for the transfer or application at any time of the whole or any part of the income or assets of the institution or fund for any purpose other than a charitable purpose.
- the institution or fund is not established for the benefit of any particular religious community or caste
  - o An institution or fund established for the benefit of Scheduled Castes, backward classes, Scheduled Tribes or of women and children shall not be deemed to be an institution or fund expressed to be for the benefit of a religious community or caste.
  - o The assessee-society was established and run by a minority Christian community but as the aim and object of the assessee-society is to train professionals in the field of medical and health care and also to provide medical facilities in their hospital to all persons of any caste, creed, race, religion, etc., accordingly it was held that the activities carried out by the assessee-society are charitable in nature and, consequently, the assessee is entitled to the registration under section 80G(5) of the Act[2].
- the institution or fund maintains regular accounts of its receipts and expenditure
- the institution or fund is either constituted as a public charitable trust or is registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India or under section 25 of the Companies Act, 1956 or under section 8 of Companies Act 2013, or is a University established by law, or is any other educational institution recognised by the Government or by a University established by law, or affiliated to any

2. *CIT vs. Christian Medical College [2015] 61 taxmann.com 68 (Punjab & Haryana)*

University established by law, or is an institution financed wholly or in part by the Government or a local authority.

Registration Procedure

- For obtaining approval the institution or fund is required to furnish application electronically in Form No. 10G along with following documents
  - o the instrument/document evidencing the creation or establishment of the fund or institution, being the applicant, such as, memorandum of association, articles of association, trust deed, rules/regulations of the applicant and those of other institutions like schools, hospitals, etc., managed by the applicant, as applicable
  - o Registration Certificate issued by concern regulatory authority
  - o accounts and balance sheet (audited accounts and balance sheet along with the audit report, where audit is required under the relevant laws) for the preceding three previous years or since inception, whichever is less; along with a note on the activities as reflected in the accounts and the annual reports with special reference to the appropriation of income towards purposes of the applicant, if applicable
  - o Copy of order granting under section 12AA or under section 10(23)or section 10(23C)
  - o application in case applied for approval under sub-clause (iv), sub-clause (v), sub-clause (vi) or sub-clause (via) of clause (23C) of section 10 or for registration under section 12AA, as applicable.
  - o order rejecting the application for grant of approval under section 80G, if any;
  - o order cancelling the registration granted under section 80G, if any
  - o Note on the activities of applicant trust or institution
  - o Any other document which will substantiate the application
- The application shall be verified by the person who is authorised to verify the return of income under section 140, as applicable to the assessee
- Such application shall be signed digitally or through electronic verification code as the case may be.
- The Principal Commissioner or Commissioner may call for such further documents or information from the applicant or cause such inquiries to be made as he may deem necessary in order to satisfy himself about the genuineness of the activities of the applicant. Usually, the following details are called:
  - o A certificate stating that provisions of Sec. 11, 12 and 13 not violated for any previous year and clarification whether the benefit of exemption u/s. 11 and 12 have been denied in any of the 3 immediate preceding assessment years
  - o Certificate showing whether the condition of Sec. 80G (5) is satisfied or not.
  - o Acknowledgement of ITR for 3 immediate preceding assessment years and if no ITR filed then the reason for the same to be mentioned

- Copy of unaudited or provisional financial statements for the year to date period
- Name/address/PAN of Trustees and place of assessment of all trustees along with telephone no. along with details if any of the trustees have changed
- If in the past 3 assessment years if Form No. 10 has been filed for exercising option for the accumulation of funds as per explanation 2 to sec. 11(1) or 11(2) for the accumulation of income the copies of such form along with a resolution passed by Board of Trustees
- NOC from the owner of the premises where the registered office is situated.
- In case 80G was not renewed immediately upon its expiry or in a case there is time lag between registration and application for 80G, a detailed note explaining the reason so as to why the 80G certificate has not been applied by the trust during the intermittent period
- Copy of the Pan Card of the Trust/ Institution.
- Copy of electricity bill, house tax receipt, or water bill
- Documents substantiating the charitable activities carried out
- List of the governing body of trustees with their contact details if the entity is Trust details of trustee containing No., address, Aadhaar and PAN No.
- Summary of objects as per Trust deed, if the entity is a Trust.
- In case trust or institution is for the advancement of any other object of general public utility, details of demand raised and penalty imposed in any assessment year.
- Details of the expenditure on religious nature if any
- Break up/list of donors (corpus and general) along with the name, address, Pan and assessment details of donors of ₹ 10,000/- and above for all 3 immediately preceding years along with the direction letter from donors in case of corpus donations. In case of foreign donations received a copy of the certificate issued by Home Ministry for foreign donations, if any, received along with a copy of bank statement and returns filed with FCRA authorities.
- Year-wise descriptive note on charitable activities of the Trust in the preceding 3 year incorporating specific activities are undertaken, a physical area in which work done, no. of persons benefited, the amount spent, etc. In case expenditure on charitable objects exceeding ₹ 10,000/- has been made to individual/institution then name, address and PAN of receiver and evidence certificate in case of donations given to any other trust.
- Copy of bank statement for the last 3 years with a narrative summary of entries exceeding ₹ 50,000/-.
- Details of addition to immovable property and TDS in respect thereof in the past 3 years.

- o Assessment details of Donors in respect of donation received amounts to ₹ 50000/- or more.
- o Details of the mandatory clauses like trust are irrevocable
  - – In the case where trust or institution is not in existence for 3 years details are required to be provided for such shorter period.
  - – However, some of the above details have been incorporated in the new application Form No. 10G which is effective from 5-11-2019.

- Where the Principal Commissioner or Commissioner is satisfied that all the conditions laid down in clauses (i) to (v) of sub-section (5) of section 80G are fulfilled by the applicant, he shall record such satisfaction in writing and grant approval under clause (vi) of sub-section (5) of section 80G and where one or more of the specified conditions are not fulfilled, he shall record the reasons in writing and reject the application for approval after giving the applicant an opportunity of being heard.
  - o If the Commissioner is convinced that the purpose of the society or the trust is not charitable, nothing debars him from denying the approval but, at the same time, if he is satisfied that the objects of the trust, as set out in the deed of declaration, were charitable, then having regard to the object of the provision, the approval should not be denied on mere technicalities. As a matter of fact, the power to grant or negative the claim for approval is coupled with a duty[3].
  - o Merely because assessee charitable educational institution was prosperous and failed to state as to why there was a need for donations and it failed to submit a list of proposed donors, approval under section 80(5)(vi) could not be denied merely upon the possibility of misuse of donations[4].
  - o An application of the Trust for grant of approval under Section 80G(5)(vi) of the Act can be turned down only if the trust fails to carry out its objects and/or violates the conditions encapsulated in Clauses (i) to (v) of Section 80G(5) of the Act. Any breach of the conditions enumerated in clauses (i) to (v) of Section 80G(5) of the Act is a precursor for refusal of the approval under Section 80G of the Act[5].
  - o The assessee's application for renewal of recognition under sec. 80G(5)(vi) cannot be rejected on the ground that its income was not being used for a charitable purpose. The question of applicability of income of assessee can be gone into by assessing authority only at the time of assessing the income of the assessee[6].
  - o The taxability of anonymous donations under section 115BBC is

3. *Sonepat Hindu Educational & Charitable Society vs. CIT [2005] 278 ITR 262 (Punj. & Har.)*
4. *Adesh Foundation (Regd.) vs. CIT(E) [2019] 105 taxmann.com 13 (Amritsar - Trib.)*
5. *CIT(E) vs. Mata Padmawati Shyamdaya Charitable Trust [2019] 101 taxmann.com 82 (Rajasthan)*
6. *D. R. Ranka Charitable Trust vs. DIT(E) [2019] 101 taxmann.com 124 (Karnataka)*

not relevant for granting registration under section 80G[7].

- o Where assessee-trust had established an institution for benefit of all sections of society and religious activities carried out by it were minuscule in comparison to its main activity, the registration of under section 80G cannot be cancelled on the ground of violation of provisions of section 13(1)(b)[8].

- The order granting approval under clause (vi) of sub-section (5) of section 80G or rejecting the application shall be passed within the period of six months from the end of the month in which such application was received. It was usually observed that application was not disposed off within the period of six months since rule provided that in computing the period of six months, any time is taken by the applicant in not complying with the directions of the Commissioner. However, upon representation said exclusion was withdrawn and hence now all application is required to be disposed within the period of 6 months from the end of the month in which such application was received.

- o The Commissioner shall pass an order either granting the approval or rejecting the application within six months from the date on which such application was made. Therefore, it is mandatory that if the application is not disposed of within six months from the date on which the application is made, the Commissioner has no jurisdiction either to pass an order granting the approval or rejecting it[9].

Conclusion

Applicant trust or institution is required to pass through the various test and comply with the various requirement in order to obtain registration under section 80G(5). However, registration under section 80G(5) will be stepping stone for the various other registrations.

7. *Shri Krishna Kirpa Gaushala Samiti vs. CIT(E) [2015] 64 taxmann.com 420 (Chandigarh-Trib.)*
8. *Shri Mahavir Sthan Nyas Samiti vs. UOI [2017] 77 taxmann.com 47 (Patna)*
9. *Maheshwari Foundation vs. DIT(E) [2015] 56 taxmann.com 393 (Karnataka)*

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The purpose of education is to make good human beings with skill and expertise... Enlightened human beings can be created by teachers.

– A. P. J. Abdul Kalam

The Origin, Challenges and Implementation of the Social Stock Exchange in India

CA Khubi G. Shah

The interesting concept of Social Stock exchange was introduced in this year's Budget by our Finance Minister Mrs. Nirmala Sitharaman. It is a revolutionary idea and a large step towards integrating NGOs and the general public. In the budget it was proposed that an electronic fund raising platform would be implemented and regulatory powers would be with The Securities and Exchange Board of India (SEBI).

The Securities and Exchange Board of India (SEBI) has formed a working group that will advise the regulator on creating Social Stock exchanges (SSE). A 15-member panel is headed by SBI Foundation director Ishaat Hussain. The committee includes Bain Capital MD Amit Chandra, who is also involved in philanthropic work, and Aavishkaar Group's founder and Chairman Vineet Rai, Manipal Global Education's TV Mohandas Pai, Omidyar Network India's managing director Rupa Kudva and BAIF Development Research Foundation president Girish Sohani are among the other members. The panel also has three representatives from SEBI, one each from the BSE and NSE, and four Government (State and Central) representatives.

Firstly let us start by understanding the origin of this idea, the underlying basic concept is related to two things the traditional Stock Exchange and the concept of Impact Investing.

In its entirety it does not specifically mimic the **Stock Exchange** but the core of the concept is analogous. Let us discuss the similarities and differences between the two, the Stock Exchange and the Social Stock Exchange; this will help us interpret the concept better.

The similarities are the basic structure and idea which is derived from the stock exchange itself. The conventional stock exchange provides a platform to various listed companies to ease their hardship of gathering funds so as to increase the level of their business, this fundamental concept of providing a recognized platform is beneficial. The differences are however many as the crux of this exchange is inclined towards social objectives whereas in a normal stock exchange the objective is commercial in nature. Further the actual functioning of both will definitely differ. Many primary concepts of a conventional stock exchange may fail to apply to a social stock exchange as their purpose is different.

Impact investing has similar roots to the concept of Social Stock Exchange. Impact investing is widely prevalent in many countries and also in India. To understand a difference between both the concepts we first need to understand its definition, Impact investments are defined as investments made into companies, organizations, and funds with the intention to generate social

or environmental impact alongside a financial return. Impact investing appeals to many potential investors because it balances commerce along with compassion.

Now we can interpret that impact investment relates to investment in a particular company/ NGO, etc. having a social, environmental or beneficial objective but also the investors covet a financial return from the same. It is a mixture of sensible traditional investment with a dual objective of philanthropy. An impact investor is a lot like a venture capitalist but other than only expecting financial return they also want to give back to the society in some beneficial way. However now taking the Social Stock Exchange, though it has similar social objectives but it provides a platform which would be wider than normal impact investing portals, it would incorporate institutions having a favourable impact and provide a unified regulated base which would protect the investors. Impact Investing is a mechanism which would form the core ideology of the Social Stock Exchange, the exchange would function as a vehicle however it would also include pure charitable ventures with no or low financial viability.

Impact investing has wide scale recognition all over the world including India. The initial impact investing firms were Aavishkaar and Acumen Fund, they instituted the concept of impact investing in India. The formation of a Social Stock Exchange will further provide boost impact investing as a regulated platform which would have stricter guidelines to safeguard investors and provide an opportunity to the listed companies to raise sufficient capital.

It is often said that if you have a good idea you can make it big, however that is not always true, there might be many people who have brilliant ideas but have no funds to execute the same in a positive manner. Though impact investing firms promote such entrepreneurs however the impact investing universe is yet not heard of by many people at large and also there needs to be a significant financial return for impact investing firms to publicise the idea and venture. This again is based on the perception of a particular impact investing firms, there might be many social entrepreneurs having extraordinary ideas but would not be lucrative as an investment this scenario needs to be tackled.

The advent of the Social Stock Exchange may in the initial stages have elementary ideas but in the future it should be able to evolve to include all kinds of social ideas. In India we have the "School of Social Entrepreneurs" whose main mission is "to address inequalities and social exclusion by supporting social entrepreneurs from all backgrounds to transform their talent into real social outcomes, in the form of sustainable solutions to poverty and disadvantaged communities", similar concept is present in United Kingdom and Canada too. However the impact investing concept in India though provides a lot of benefit, there should be more awareness created about their business mechanism, if the Social Stock Exchange in India allows the listing of impact investing firms it would go a long way in helping boost investment, the pool of investors would be larger. The Social Stock Exchange can provide a regulated platform, which would provide a more secure and reliable structure for impact investing firms.

Many will question the reason for creating a Social Stock Exchange, as there already is a presence of impact investing prevalent in India, however there are no regulated guidelines or committees overseeing the same in India yet. Though India has an impact investing council includes 30+ active impact investors, it is not that government regulated. The Social Stock Exchange can directly connect the actual investors with institutions to enhance a faster pace of social development in India. Even after the conclusion of the Budget Speech, the SSE concept mentioned was yet vague, there was no mention of any

guidelines or committees only that it would come under the ambit of the Securities and Exchange Board of India, however this should not be the case with SSE, before the formal implementation of Social Stock Exchange in India there should be proper regulations in place so as to encourage investment into socially acceptable projects through the medium of the SSE.

Emergence of the concept of Social Impact Bonds and Development Impact Bonds

Social Impact Bonds

A social impact bond (SIB) is a contract with the public sector or governing authority, whereby it pays for better social outcomes in certain areas and passes on the part of the savings achieved to investors. However if the objectives are no achieved for which the bond was issued then investors would receive no return as return is contingent on the fulfillment of the predetermined social objective. SIBs derive their name from the fact that their investors are typically those who are interested in not just the financial return on their investment, but also in its social impact. It is a new vehicle that brings together private investors, the Government, and nonprofits to take on social problems. With a SIB, private investors lend money to a social service provider, and the provider is expected to meet terms of success by a certain date. If these goals are met, then the government repays the private investors. If not, the Government pays nothing. This concept has not been introduced in India yet but many countries have implemented SIBs; UK, US, Australia, Canada, South Korea, Germany, etc.

However this is not as popular in India because for developing countries the government revenue would get affected. Development Impact Bonds are more beneficial for developing countries.

Development Impact Bonds

DIBs are results-based contracts in which one or more private investors provide working capital for social programmes, implemented by service providers (e.g., NGOs), and one or more outcome funders (e.g., public sector agencies, donors, etc.) pays back the investors their principal plus a return if, and only if, these programmes succeed in delivering results. They are the same as Social Impact Bonds (SIBs), with one key difference. In a SIB the outcome payer is typically the Government in high-income countries, while in a DIB the outcome payer is typically a private donor or aid agency. DIBs are most appropriate in scenarios when there is an actor that is willing to pay for the results, but not willing to bear the risk that the activities won't yield the desired results. As such, DIBs present an alternate pathway to funding by involving investors that have more flexibility in where and how they choose to invest their money, after accounting for the risk adjusted return.

Till date only one DIB has been launched in India by British Asian Trust and UBS Optimus Foundation who have launched a development impact bond (DIB) worth $11 million, to invest in NGOs and social enterprises for improving quality of education in India.

Global Securities Market by BSE

In 2019, BSE the Bombay Stock Exchange came up with its own green bond trading platform called as GSM Global Securities Market, it will serve as a platform for fundaising and trading green, social, and sustainable bonds exclusively. This was a concept initially proposed by the United Nations in its idea of a Sustainable Stock Exchange whose main motive is to promote all the countries capital markets to follow Sustainable Development goals and provide initiative for the same. The GSM is established through BSE's International wing called India International Exchange, the GSM lists Green bonds along with other types of securities like Foreign Currency bonds, Masala bonds, etc. The first Green bonds to be listed were of Adani Green Energy Limited. Though this is a significant step for achieving

social objectives however this brings into ambit only big already listed companies, and not all companies having social objectives.

To bring these bonds within the ambit of the Social Stock Exchange would provide a one stop solution to all as private investors would have a electronic platform to invest an earn reasonable contingent return as well as ensuring social impact.

Intended challenges which are to be faced

1. The companies/institutions that would be allowed listing on this exchange?

2. The mechanism that would be put in place so as to prevent the misuse the funds raised by the listed companies? Would there be a separate intricate audit that would be carried out for each listed company as to prevent them from misutilizing the public investment received?

3. Would there be actual trading on this exchange?

4. Would the exchange be a portal for responsible investment by investors only or would it also be a platform where donations would be accepted too.

5. If section 8 companies would be included in the definition of companies that can be listed, there would be violation of the section itself as section 8 companies are mandatorily supposed to reinvest their profits in their own objects itself and no dividend can be distributed to its shareholders, this contradicts with the requirement of providing the investors with a financial return.

6. Further if due to the above only and only companies can be listed (not section 8 companies) it would defeat the purpose of the Social Stock Exchange as it would benefit only the commercial companies who have their main purpose as profit but have a few social objects to satisfy their Corporate Social Responsibility objectives. The social projects these companies undertake are ancillary whereas for section 8 companies and other charitable institutions their sole purpose for creation is for the public benefit.

7. If only companies (not section 8 companies) are listed, then it would not really justify the proposal for creation of such a exchange as such companies have sufficient funds to divert to these projects initiated by them, whereas there are other companies in the ambit which rely on source of funds from the public for continuing their charitable purpose.

8. One would question the above fact that if section 8 companies and other institutions are allowed to be listed then there are many such section 8 companies and trusts who are subsidiaries of a wealthy parent company group or their trustees are high net worth individuals who have a lot of capital to invest in their own section 8 companies and their own trusts/ institutions, therefore if they get listed and source public income through investors it would be detrimental to other NGOs/ trusts/section 8 companies and institutions which who not have such solid financial backing.

9. If financial return would be provided to all investors wouldn't the promoter of the companies/or trustees of a trust maintain a high concentration of their own companies/trusts shares and earn income by way of dividend which would lead to diverting the funds into their own pockets.

10. Specifications of the vetting process which would be followed to determine the eligible companies that can be listed. In case a

company acts as a conduit for providing funds to a social entrepreneur as their main objective, e.g., Impact investing firms whose main aim is to act as an agent who invests in startups in rural and backward areas or entrepreneurs who have a favorable social/environmental/etc. impact would these companies be listed? Their investors do require a significant developmental return, how would this factor in?

11. Issue of securities by a company listed on the Social Stock Exchange if permitted then type of securities would be questioned it would include only equity or debt oriented securities would be included to?

12. Usually section 8 companies and trusts/ institutions breakeven or generally have a deficit/ in such a case how would they provide a financial return to the investors.

Possibilities of Foreign Contribution

In a traditional stock exchange we allow foreign investors to invest in Indian Companies Stocks either by way of FII (Foreign Institutional Investors), QFI (Qualified Institutional Investors), ADR's (American Depository Receipts), ETR's Exchange Traded Funds. Receipt of foreign funds would be advantageous as there would be more funds available for social impact.

Proposed Framework for the functioning of the Indian SSE

Ideas can be taken from different countries as stated above, but all in all it should be beneficial for our country itself.

Initial Stage

The nascent stage should be less complex so as to encourage investment. It should however not be limited to listed companies only it should also include section 8 companies.

- The prescribed section 8 companies and listed companies can become listed entities on the Social Stock Exchange. For section 8 companies however specific rules for listing should be present such as

  i. 5 year track record,

  ii. List of annual expenditures for the objects of the company for the preceding 5 years,

  iii. Preliminary Audit to be conducted by SEBI Certified Associates, Chartered Accountants, etc.

  iv. List of projects to be implemented and already implemented, etc.

- For charitable organizations (such as trusts and institutions) there will be additional rules applicable over and above the rules mentioned above such as:

  i. The List of Trustees will be made public and they will be personally liable for any misutilisation of funds

  ii. Only 12AA registered trusts & societies will be allowed to be registered

- To approve the listing status of an entity will be at the discretion of SEBI entirely.

- Listed companies would be classified as Class-I and Section 8 Not for Profit companies as Class-II companies. Rules and regulations for functioning on the exchange of both Class-I and Class-II companies would be different.

CLASS-I	*CLASS-II*
1. The Companies falling in this class would be: a. Companies already listed on the NSE or BSE and b. Impact investing firms who are limited companies. (i.e. not private limited companies and section 8 companies, trusts, etc.)	1. This class would include a. Section 8 Companies and b. Charitable Trusts c. Societies (registered under the Societies Registration Act, 1860)
2. Initial issue of shares would be project wise for each project. For example if Tata Chemicals Limited has obtained registration on the Social Stock Exchange then the company will be listed but investors will invest in their particular projects not in the company, so shares will be issued for that project.	2. In this case section 8 companies will not issue any security but they will publicize the list of their forthcoming projects and causes for which investment is required and they will obtain funding through donations and issue donation receipts.
3. They will provide a minimum return to the investors when they eventually earn profits from the project, in case of loss no return would be provided	3. No return will be provided, but exemption benefit will be given to the investors at a percentage higher than stated in section 80G of the Income-tax Act, 1961.
4. There would be trading available based on the SEBI's guidelines	4. No trading would be done, it is a mere platform for collecting funds
5. All individuals can invest in Class I companies. However they should have the necessary risk appetite to handle no return in case the project fails to generate profit.	5. All individuals can invest in Class II companies.
6. The expenses of listing will be allowed as deduction as business expenses	6. The expenses of listing will be treated as application of income.
7. The listing charges should be higher than Class II companies. There should be an annual registration charge payable.	7. The listing charges should be minimal so as to encourage listing on the Social Stock Exchange.
8. In case of already listed companies no further investigation will be carried out. But for impact investing firms investigation of their track record, analysis of the past funds raised, etc. would be investigated before listing the same.	8. Before listing is allowed firm investigation would be carried out of the past and recent projects, the track record, the records of utilization by investigating officers then only listing will be provided.

CLASS-I		*CLASS-II*	
9.	SEBI audit would be applicable for each project separately, over and above the normal audits carried out in a financial year.	9.	SEBI will provide guidelines which need to be complied with, by the auditors.
10.	Penalties In case of siphoning of funds the normal penalties as mentioned in the Companies Act, 2013 will be followed.	10.	Penalties a. In this case for section 8 companies, Companies Act, 2013 will be applicable, b. In case of trusts & societies and other institutions a penalty clause should be introduced in their respective Acts.
11.	In the future these CLASS-I companies would come under the roof of NSE/BSE only once they create a social impact arm. e.g. BSE has already taken an initiative as mentioned above the Green bond initiative	11.	In the future the Social Stock Exchange would refer to only these CLASS-II companies.
12.	For foreign contribution separate guidelines should be present as foreign revenue would enlarge the funds available for utilization	12.	In this case Foreign Contribution Regulation Act, FCRA (Regulation), 2010 will be applicable and the CLASS II will have to be registered before they can access foreign revenue.

Other Common points which can be used in the final implementation are as under:

- A user friendly website should be created so that individual investors can register themselves and use the log-in ID to invest.
- The website should list all the companies (Class I and Class II) and include a list of all projects with a separate link which connects to the company's website, in this way it will be interactive and it will allow the investors to invest/donate for their choice of cause.
- The SEBI regulations regarding listing of projects by Class I and Class II companies should include a thorough analysis report before listing and an annual/bi annual or more frequent checks should be prescribed.
- The companies that are listed will have to introduce iron clad controls so as to monitor the spending of the public money. Tougher procedures and checks need to be implemented by the company and the regulatory body. As in the case the social impact to which the public is donating too should be actually where their money is spent, there should be accountability to the investors financially as well as socially.

The above implementation structure is a general idea and as and when the concept of investing and donating wisely for our country builds in the masses, we could use the SSE Social Stock Exchange as a vehicle to mobilise funds for positive social impact

This concept has already been implemented in a handful of countries albeit with different

functioning mechanisms. Social Stock Exchange in various countries has been implemented through different mechanisms though the primary idea is the same for all but the way of functioning is not similar. For example the Singapore Stock Exchange allows Social Enterprises to issue debt securities while in the UK it functions as a directory i.e., it just connects the social enterprises and potential investors.

The countries which have implemented this concept are as follows:

a. ***Canada***: In Canada the Social Stock Exchange concept is called as SVX (Social Venture Connexion) which serves as an online platform where even retail investors can invest in funds/companies with a social impact. However concept is functional only in Ontario as it is backed by the Ontario government, not entire Canada. The SVX is a platform which is registered as a restricted dealer with the Ontario Securities Commission (much like the SEBI in India)

b. ***UK***: The Social Stock Exchange in London functions more as a directory connecting social enterprises and potential investors. Launched in 2013, it only accepts companies that pass its independent assessment on social impact. Unlike the Canadian Stock Exchange it is not a market atmosphere it does not facilitate share trading. It also acts as a research service so as to facilitate an interaction between potential investors and companies.

c. ***Kenya***: The Kenya Social Investment Exchange connects social enterprises with both foreign and domestic impact investors.

d. ***Singapore***: The Impact Investment Exchange runs a Social Stock Exchange in partnership with the Stock Exchange of Mauritius, which is open to limited accredited investors who want to invest in social enterprises. It includes nonprofits in its list of issuers, which can issue debt securities such as bonds.

e. ***South Africa***: It works like a conventional Social Stock Exchange and offers ethical investors a platform to buy shares in social projects according to two classifications: sector and province.

Brazilian SSE is similar to the South African model and South African SSEs are more akin to online matchmaking platforms than investment platform, interested investors can browse and select social businesses based on project type, mission, and location.

A wider recognition is required for novel ideas which can revolutionize the social landscape of our country. The Social Stock Exchange in a way would bridge the gap between such ideas and pool of investors. In the introductory phase, there may be a smaller congregation of companies but in the future it should provide an opportunity for advancement and improvement to all entities. This move when eventually ascertained is set to help sustain the environment and help proper distribution of wealth so as to reduce inequality. It will also help millions of people living in poverty and in backward areas; with SSE we can all see a more equal India and a better India, with a wide array of opportunities for people to invest judiciously for the development of our country.

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Accounting, Auditing under Income-tax Act and Maharashtra Public Trusts Act – Accounting Standards applicable ?

CA Himanshu Kishnadwala

1. Introduction

Charitable Institutions enjoy various exemptions and receive incentives under various fiscal laws of the Central Government as well as the State Governments. Generally, such exemptions or incentives are granted subject to compliance with several conditions. One of the important conditions for this is that the Institutions claiming exemption must get its accounts audited.

The focus of this article is to examine the provisions relating to audit of accounts of those institutions which claim exemptions under section 10(23C) and section 11 of the Income-tax Act, 1961 ('the ITA'). Also, the law governing maintenance of accounts by the charitable institutions are also discussed.

The institutions claiming such exemption may be a Trust, a Society, or a Company registered under section 8 of the Companies Act, 2013 ('the 2013 Act') or section 25 of the erstwhile Companies Act, 1956 ('the 1956 Act') or any other legal entity. For the purpose of this article, these entities have been referred to as Non-Profit Organisations ('NPOs') or 'Institutions'.

2. Statutory Provisions for audit

2.1 As per tenth proviso to section 10(23C) of the ITA, the following NPOs claiming exemption under section 10(23C) are required to get its accounts audited when their total income, (without giving effect to the exemption provisions) exceeds the maximum amount not chargeable to tax:

i) NPOs established for charitable purposes and approved by the prescribed authority under section 10(23C)(iv) of the ITA;

ii) NPOs established wholly for public religious purposes or wholly for public religious and charitable purposes and approved by the prescribed authority under section 10(23C)(v) of the ITA;

iii) NPOs existing solely for educational purposes and not for profit under section 10(23C)(vi) of the ITA; and

iv) Hospitals or other medical Institutions existing solely for philanthropic

purposes and 'not for profit' under section 10(23C)(via) of the ITA.

However, educational or medical institutions which fulfil following conditions are not required to get its accounts audited under tenth proviso to section 10(23C) of the ITA:

- Institutions covered under section 10(23C)(iiiab) and section 10(23C)(iiiac) which are wholly or substantially financed by the Government. The Institution shall be considered as being substantially financed by the Government if the Government grant to such Institution exceeds 50% of total receipts during the relevant previous year. Total receipts for the purpose would also include voluntary contribution received during the year; or
- Institutions covered under section 10(23C)(iiiad) and section 10(23C)(iiiae) where the aggregate annual receipts does not exceed the amount prescribed (currently ₹ 1 crore) under Rule 2BC of the Income tax Rules, 1962 ('the IT Rules').

2.2 As per Rule 16CC of the IT Rules, the audit report of the Institutions described in para 2.1 above shall be in Form No. 10BB;

2.3 In cases where the NPO claims exemption under section 11 of the ITA, then as per section 12A of the ITA, the NPO whose total income, without giving effect to the provisions of section 11 and section 12, exceeds the maximum amount which is not chargeable to tax, is required to get its accounts audited. The audit report shall be in Form No. 10B as prescribed under Rule 17B of the IT Rules.

2.4 For the purpose of determining whether the total income has exceeded the maximum amount not chargeable to tax, contributions made with a specific direction that they shall form part of the corpus of the Institution, are also to be included/considered;

2.5 As per section 2(15) of ITA, "Charitable purpose" includes not only relief of the poor, education and medical relief, but also the advancement of other objects of general public utility. However, the advancement of other objects of general public utility shall not be regarded as charitable activity, if it involves the carrying on of 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, for a cess or a fee or any other consideration and the aggregate receipts from such activity exceeds twenty percent of the total receipts of the Institution. This is irrespective of the fact whether the income earned therefrom is applied for the charitable purpose or otherwise.

3. Maintenance of Accounts

3.1 As per section 145 of the ITA, the Institution has the option to maintain its books of account either in accordance with cash system or mercantile system of accounting. However, section 128 of the 2013 Act, requires a company to maintain its books of account as per accrual system of accounting. Therefore, an Institution which is a company registered under section 8 of the 2013 Act or section 25 of the 1956 Act, has to maintain its books of account as per accrual system of accounting. However, the non-corporate Institution has the option to maintain its books of account as per cash system of accounting;

3.2 Further, it is necessary that the accounts of the Institution are prepared in accordance with the generally accepted accounting principles, which includes, keeping distinction between transactions which are of capital and revenue in nature. Under the ITA, for example, cost of purchase of fixed assets could be considered as application of income in order to determine taxable income. Yet in the books of account, the same would be considered as transaction of capital nature and the cost thereof would be shown in the Balance Sheet. The Balance Sheet would therefore summarise Assets and Liabilities, and the Income and Expenditure Account would enumerate items of income and expenditure.

3.3 In case the Institution receives donation in kind, e.g., books, furniture items, medical equipments, etc., such items are considered as grants in the form of non-monetary assets and accordingly, should be accounted for as per Accounting Standard 12 'Accounting for Government Grants', which requires that non-monetary grants should be accounted for at a nominal value (say rupee one);

3.4 As per the provisions under the Maharashtra Public Trusts Act balance sheet and income and expenditure account should be as per Form Schedules VIII and IX respectively. Also, under section 34 of the Maharashtra Public Trusts Act, it is the Auditor's duty to prepare Balance Sheet and Income and Expenditure Account. In cases where the Institution is registered under the 2013 Act, the Balance sheet and Income and Expenditure Account is to be prepared as per Schedule III of the 2013 Act. In addition, the Institution registered under the 2013 Act is also required to prepare cash flow statement.

4. Accounting Standards

The applicability or otherwise of the Accounting Standards would depend on whether the NPO is a corporate entity or a non-corporate entity, the type of activity carried on by it and the method of accounting followed.

4.1 In case of a corporate entity

These entities are governed by the provisions of the 2013 Act. As per the provisions of section 129 of the 2013 Act, the financial statements of a company, including a company engaged in charitable activity, is required to comply with the Accounting Standards (or the Indian Accounting Standards (Ind AS), as the case maybe) notified under section 133 of the 2013 Act. A company which is engaged in charitable activities is not given any kind of exemption.

4.2 In case of a non-corporate entity

- As per para 3.3 of the Preface to the Statements of Accounting Standards issued by Institute of Chartered Accountants of India ('ICAI'), *"Accounting Standards apply in respect of any enterprise (whether organised in corporate, co-operative or other forms) engaged in commercial, industrial or business activities, irrespective of whether it is profit oriented or it is established for charitable or religious purposes. Accounting Standards will not, however, apply to enterprises only carrying on the activities which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Exclusion of an enterprise from the applicability of the Accounting Standards would be permissible only if no part of the activity of such enterprise is commercial, industrial or business in nature. Even if a very small proportion of the activities of an enterprise is considered to be commercial, industrial or*

business in nature, the Accounting Standards would apply to all its activities including those which are not commercial, industrial or business in nature".

Thus, if the activity of a non-corporate Institution involves carrying on of 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, even when such activity is for advancement of charitable objects, then Accounting Standards issued by the ICAI would be applicable to such non- corporate Institutions.

- Where there is no statutory requirement for preparation and presentation of financial statements on accrual basis, the Institution has the option to prepare its financial statements on a basis other than 'accrual', say, cash system of accounting. However, such Institution is required to ensure that the provisions of the accounting standards which are applicable in the context of the basis of accounting followed by the Institution, have been complied with.

5. Income Computation and Disclosure Standards ('ICDS')

5.1 The Central Government *vide* Notification No. 32/2015 dated 31st March, 2015 has notified ICDS under section 145(2) of ITA. The same are applicable to all assessees following mercantile system of accounting.

5.2 ICDS also apply to NPOs. However, if the Institution maintains its books of accounts as per cash system of accounting, ICDS are not applicable. Also, it may be noted that ICDS does not affect the manner in which the books of account are maintained or the financial statements are prepared. The same are only to be applied for computation of income under the heads 'Profits and gains of business or profession' or 'Income from other sources' under the ITA.

5.3 The taxable Income after applying ICDS may vary from the income as per the financial statements, since ICDS requires the assessee to treat certain items of receipts and payments in a particular manner. For example:

- The Institution which accounts interest income as and when received would be required to compute the same on accrual basis for income tax purpose;
- As per ICDS the recognition of grant cannot be postponed beyond the date of actual receipt (irrespective of whether the conditions attaching to the grant have been or will be fulfilled);
- Grants relating to a depreciable fixed asset should be deducted from its actual cost or written down value of block of assets.

6. Applicability of Standards on Auditing

6.1 The nature of audit of NPOs mentioned above is similar to that of audit of general-purpose financial statements. Hence, the audit procedures as prescribed under Standards on Audit ('SA') issued by the ICAI shall also be applicable. Thus, the auditor is expected to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require, considering the contents of the audit report. Special attention is drawn to the following:

- **SA-210 – Agreeing the terms of Audit Engagement:** The objective

of this SA is to ensure that the preconditions for an audit are present and the trustees acknowledge and understand their responsibility. Since in most cases NPOs are run by honourary members who may not have required knowledge and understanding, the auditor must ensure that this SA is complied with;

- **SA-230 – Audit Documentation:** An audit under the ITA is also an Attestation Engagement and thus is covered by the Statement of Peer Review and adequate documentation for the same is necessary;
- **SA-250 - Consideration of Laws and Regulations in an Audit of Financial Statements:** Depending on its constitution, the laws applicable to the Institutions would differ with each other. This SA deals with the auditor's responsibility to consider laws and regulations while conducting audit of the Institution. Though the auditor is not required to verify or certify about the compliance with the provisions of other laws, if such non-compliance affects the truth and fairness of the accounts, then it is the duty of the auditor to verify the compliance thereof;
- **SA-315 – Identifying and Assessing the Risk of Material mis-statement:** In most cases, NPOs are run by the honourary persons who lack the required knowledge and/or experience to keep and maintain accounts and other records. Therefore, the controls and checks necessary to run the Institution may not be in place or may be inadequate. This SA deals with auditor's responsibility to identify and assess the risk of material mis-statement in the financial statements, through understanding the entity and its environment, including the entity's internal control;
- **SA-320 – Materiality in Planning and Performing an Audit:** This Standard deals with the auditor's responsibility to apply the concept of materiality in planning and performing an audit of financial statements. For the reasons stated as above and in order to mitigate the risk of material mis-statement, this Standard assumes more importance while conducting the audit of the Institutions;
- **SA-500 – Audit Evidence:** Many a times the charitable Institutions do not have the formal system of record keeping which makes the task of the auditor more difficult. Therefore, it is important that the auditor applies the procedure as given in this Standard;
- **SA-600 – Using the Work of another Auditor:** If the Institution is constituted under other laws, which in turn also provides for the statutory audit, then the auditor doing the audit under the ITA would be entitled to rely on the report of the statutory auditor, to such extent and in such manner as provided in the Standard;
- **SA-580 – Written Representations:** This Standard deals with the auditor's responsibility to obtain written representations from management/ trustees with the objectives that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness

of the information provided to the auditor and to support other audit evidence or specific observations.

It may also be mentioned that, in view of the peculiar nature of the NPOs, the accounting system and procedures followed may differ widely from normally observed in a business organisation. For example, donations in kind may be received defying precise quantitative and monetary values. In such circumstances, the auditor, apart from applying his usual checks and scrutiny, will have to rely on the management representation. The management representation may also be obtained with respect to the transactions entered into with the persons specified u/s 13(3).

6.2 ICAI has also issued 'Guidance Note on Audit of Public Charitable Institutions under the Income-tax Act, 1961' The auditor is also expected to follow the same while discharging the attest function.

7. Audit Report

7.1 In its audit report (in Form 10B or Form 10BB), the auditor is required to:

- State whether the Balance sheet and Income and Expenditure account ('the Financial Statements') are in agreement with the books of account maintained;
- Express his opinion as to: (i) the maintenance of books of account; and (ii) whether the financial statements give true and fair view in the case of Balance sheet, about its state of affairs and in the case of Income and Expenditure account, about the surplus or deficit for the year;
- Annex particulars as prescribed. With respect to the same, although there is no specific requirement to certify the correctness of the particulars, since the auditor is required to put his signature at the end of the particulars, it implies that the auditor is taking the responsibility for verifying the correctness of the particulars given in the Annexure.

7.2 With reference to the Annexure, the Auditor has to verify following particulars:

- Application of income towards the objects of the Institution;
- Accumulation of income and its investment and its subsequent utilization;
- Investments held by the Institution in violation of section 11(5) of the ITA, including where the Institution is covered under section 11 of the ITA, the particulars of those investments held in concerns in which persons referred to in section 13(3) have a substantial interest.

7.3 In case of audit carried out under section 10(23C) following additional information is to be verified:

- Business, if any, carried on is incidental to the attainment of the objects of the Institution or not;
- Any sum paid, out of the accumulated income, to the Institutions registered under section 12AA;
- Particulars regarding anonymous donation.

7.4 Similarly, in case of audit under section 12A(1)(b) following additional information is to be furnished:

- Income eligible for exemption under section 11(1)(c);
- Application or use of income or property for the benefit of persons referred to in section 13(3);

With reference to the persons covered u/s 13(3), the CBDT has clarified that the auditor can accept, as correct, the list of specified persons given by the managing trustees and base his report on the strength of this certificate.

7.5 While preparing his report, the auditor should also consider the following:

- In terms of the 'Announcement' by ICAI in January 1994, where the Institution is not statutorily required to prepare and present its financial statements on accrual basis, and the financial statements have been prepared on a basis other than 'accrual', e.g. cash basis of accounting, the auditor is required to describe in his audit report, the basis of accounting followed, without necessarily making it a subject matter of a qualification. Further, the auditor is required to examine whether those provisions of the accounting standards which are applicable in the context of the basis of accounting followed by the Institution, have been complied with or not and consider making suitable disclosures/qualifications in his audit report.

7.6 ***Format of Audit Report***

SA 700 (Revised), SA 705 (Revised) and SA 706 (Revised) deal with form and content of the auditor's report. Depending on whether the auditor expresses unmodified or modified opinion or whether the report includes paragraph on Emphasis of Matter, the Standard explains how the form and content of the Report are affected. While conducting the audit of the Institutions, the auditor may be obliged to use a layout or wording in the auditor's report that differs from that described in these SA. In such circumstances the SA provides that if each of the elements identified in paragraph 48 (a)-(i) of SA 700 (Revised) are included in the auditor's report, the auditor's report can refer to SA and it would be considered that the auditor has complied with the requirements of SAs, even when the layout and wording used in the auditor's report are specified by legal or regulatory reporting requirements.

The prescribed form of the report requires the auditor to state the reasons for any qualification in the report or for any negative answer therein.

7.7 With respect to charitable and religious trusts, CBDT has issued following clarifications:

- The following would amount to application of income towards the objects of the Institution:
  - Repayment of loan originally taken by the Institution to fulfil its objects;
  - In case of the educational trust, loan scholarship granted;
  - Utilisation of capital gains earned in acquisition of new capital assets.
- In case the Institution desires to accumulate or sets apart more than 15% of its income, in order to avoid taxation under section 11(1)(a) it is essential amongst others that, it invests the entire amount of

the sum so accumulated (including the exempted portion) in the modes specified under section 11(5).

7.8 The auditor should also keep in mind the following observations in various judicial decisions:

- Application of income towards the objects of the Institution would include:
  - Capital expenditure incurred, including the acquisition of fixed assets, by the Institution.
  - Payment of taxes.
- 15% of the income which automatically qualifies for exemption has to be worked out on the gross income before reducing the amount applied for charitable purposes during the year.
- Condition of application of income to corpus donation received during the year do not apply.
- Repayment of loan scholarship cannot constitute income of the Institution, even if it had claimed as an application of income, when such loan scholarship was granted.

7.9 The auditor should also bear in mind that the provisions of section 14A have no implication on income of the Institution (which is covered under Chapter III of the ITA) as the said section applies only to computation of total income under Chapter IV of the ITA. Also, from assessment year 2018-19 corpus donation by one Institution to another which was earlier considered as application of income, will not be so considered.

8. Conclusion

Charitable institutions in India are generally run by honourary members who though are motivated and dedicated to the cause of the NPOs, in large number of cases, they lack required knowledge on regulatory requirements. There has also been substantial increase in compliance related regulations and non-compliance thereof can have serious implications. The auditors of these NPOs would therefore have to exercise much more caution and care to ensure due compliance with the applicable regulations.

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The world has today 546 nuclear plants generating electricity. Their experience is being continuously researched, and feedback should be provided to all. Nuclear scientists have to interact with the people of the nation, and academic institutions continuously update nuclear power generation technology and safety.

– A. P. J. Abdul Kalam

Analysis of Chapter XII-EB : Levying exit tax on certain Charitable Institutions

CA R. S. Kadakia, Aditya Bhatt *Advocate*

1. **Background**

   Chapter XII-EB (consisting of sections 115TD to 115TF) has been inserted in the Income-tax Act, 1961 ("the Act") by Finance Act, 2016 with effect from 1st June, 2016 to provide for levy of additional income-tax upon a charitable institution in certain situations. Rule 17CB has also been deemed to come into force with retrospective effect from 1st June, 2016.

   This article aims to analyse some issues arising out of the provisions of Chapter XII-EB and Rule 17CB.

2. The Chapter applies if **all** the following conditions are fulfilled:

   - A trust or institution ("institution") is registered under section 12A/12AA.
   - The institution has converted into any form which is not eligible for grant of registration under section 12AA.

     or

     The institution has merged with any entity; and the entity does not have objects similar to it or is not registered under section 12AA/12A.

     or

     The institution is dissolved and it has failed to transfer upon dissolution all its assets to a specified institution or such transfer has not happened within a period of twelve months from the end of the month in which the dissolution takes place.

Implications

- If the aforesaid conditions in (a) and (b)(i) or (b)(ii) or (b)(iii) are fulfilled, then in addition to the income-tax chargeable on the total income of the institution

  o the institution shall be charged to tax on its accreted income;

  o such accreted income shall be computed on the 'specified date';

  o such tax shall be levied at the maximum marginal rate on the accreted income;

  o such tax shall be paid within specified period

- The tax on the accreted income shall be treated as the final payment of tax in respect of the said income and no further credit therefor shall be claimed by the institution or by any other person in respect of the amount of tax so paid.
- No deduction under any other provision of the Act shall be allowed to the institution or any other person in respect of the income which has been charged to tax under section 115TD(1) or the tax thereon.

3. Analysis

3.1 Chapter XII-EB applies to all institutions registered under section 12A/12AA, including religious institutions, hospitals, schools, colleges, those for relief of 'poor', etc.

3.2 The section applies to an institution registered under section 12A/12AA and whose registration is cancelled or who has adopted or undertaken modification of objects without fresh registration. For exemption under section 10(23C), a trust need not be registered under section 12A/12AA ***[CIT(E) vs. Smt. Shanti Devi Educational Trust, (2019) 102 taxmann.com 141 (P&H), para 8***]. Hence, the revocation of approval under section 10(23C)(iv) to (via) does not attract section 115TD, unless the institution whose approval is so revoked has also obtained registration under section 12A/12AA and the said registration is cancelled.

Likewise, the situations of merger with dissimilar objects or dissolution without transfer of assets also do not apply to an institution who is obtaining exemption under section 10(23C) but is not registered under section 12A/12AA.

Thus, for identical default, there is discrimination between assessees covered by section 10(23C) and other trusts covered by section 12A/12AA.

3.3 The provision applies to events happening on and after 1-6-2016; it does not apply to the entire previous year 2016-17, relevant to assessment year 2017-18; to illustrate, suppose, the registration was cancelled on 30-4-2016; now, tax is payable within 14 days; however, on the date of cancellation (taxable event) the law was not in force. **Hence, it appears that the said event occurring before 1-6-2016 will not attract tax.**

3.4 Mere modification of objects will not result in the institution being deemed to be converted into any form not eligible for registration under section 12AA. It is only if the modifications are such that they do not conform to the conditions of registration that the provision will become applicable.

3.5 Merger of the institution with another entity

- Section 115TD(1)(b) provides that the accreted tax shall be triggered even in a case where an institution is merged with an entity registered under section 12A/12AA, if such entity is not having objects similar to it. The word 'similar' is subjective and prone to litigation.
- The tax is triggered if objects are not similar. It is now well-settled that there is a difference between objects and powers [***Thiagarajar Charities vs. ACIT, (1997) 225 ITR 1010 (SC); CIT vs. FICCI, (1981) 130 ITR 186 (SC)***]. Thus, what is relevant is similarity in objects and not similarity in powers or activities. To illustrate, suppose there are two institutions,

both having objects of education and medical relief. Suppose the first one is running a hospital and the second one is running a school. In this case, although the activities are dissimilar, since the objects are similar, it could be argued that it is not a merger of two institutions which do not have similar objects and hence the tax on accreted income is not triggered.

- There are three types of objects; namely, primary/dominant, allied, and ancillary/incidental/subsidiary or other objects.
- It is not clear which of the above objects have to be similar. It would be safer to have similarity in all objects.
- The satisfaction or otherwise of the condition has to be tested on the date of merger. If the merging institutions amend their objects before the merger and ensure that their objects are similar, and the amended objects are duly approved by the Commissioner under section 12AA, it could be argued that the subsequent merger is of institutions with similar objects.
- Merger should be with an institution registered under section 12A/12AA having similar objects, while upon dissolution, assets can be transferred to any institution registered under section 12A/12AA having dissimilar objects.
- The implication would be same even if the amalgamation has been done under a common scheme framed by the Charity Commissioner under section 50/50A of Maharashtra Public Trusts Act, 1950.
- The aforesaid situation is not relevant for companies listed under section 8 of the Companies Act, 2013 since they can amalgamate only with other section 8 companies having similar objects [see section 8(10)].

3.6 Failure to transfer assets upon dissolution

- Section 10(23C)(iiiab) to (iiiae) deal with institutions substantially financed by Government or which have turnover below the specified limit. Under section 115TD(1)(c), transfer to even such institutions is not reckoned! Thus, even if a charitable institution transfers its assets to an institution substantially financed by government or which has turnover not exceeding the specified limit, it will still be liable to tax under 115TD(1)(c), if the said institution is registered under section 12A/12AA.
- For the purpose of section 115TD(1)(c), accreted income is to be calculated on date of dissolution. If the trust has, prior to its dissolution, transferred assets to any person, such assets will not be includible in the calculation of accreted income on the specified date, that is, date of dissolution. What does the term 'transfer' in section 115TD(1)(c) signify? Does it mean transfer of asset in strict sense under Transfer of Property Act, 1872 or merely handing over possession is sufficient? It appears that the latter view is the correct view.
- Section 115TF(2) provides that the person (other than specified institution) to whom an asset has been transferred and who *bona fide* receives such asset shall automatically deemed to be an assessee in default and all the provisions of the Act for the collection and recovery of income

tax shall apply to him. To illustrate, if the dissolution takes place on 1-4-2020 and an institution receives certain assets on 1-5-2020 and if the donor has not transferred all its assets as required by section 115TD(1)(c), then, the donee shall be regarded as an assessee in default on 31-3-2021!! Further, the donee shall in addition to the amount of tax will also be liable to interest under section 220(2) and penalty under section 221!!!

3.7 The tax is payable by the institution as well as by the principal officer of the institution.

The manner in which section 115TD(5) is worded, it gives an impression that the primary liability is on the principal officer and the institution shall "also be liable to pay the tax". On the other hand, so far as liability of interest under section 115TE or the default under section 115TF are concerned, the provisions state that "he or it" shall be liable, suggesting that both, the principal officer and the assessee, are equally liable. Further, all the principal officers, irrespective of the level of involvement will be liable without any exception.

The AO can consider almost any person connected with the management or administration as the principal officer of the institution on account of the definition in section 2(35). Unlike proviso to section 115TF(2), there is no provision that the liability is restricted to the assets of the institution. Hence, on a plain language, the tax could be recovered from the personal assets of the principal officer also. He would also be liable to pay interest on the default. He will also be deemed to the assessee in default in respect of the amount to be payable by him!!

3.8 Capital gains chargeable on subsequent sale of asset

Where capital gain arises from transfer of capital asset being asset held by the institution in respect of which exit tax has been computed and paid, the cost of acquisition of such asset will be deemed to be FMV of the asset which has been taken into account for computation of exit tax [section 49(8)]. Thus, if an asset which has been reckoned for the purpose of computation of exit tax is sold subsequently, the FMV of such asset shall be deemed to be the cost of acquisition for the purpose of computation of capital gains. However, on a literal reading, if an asset is sold for the purpose of paying the exit tax, this provision will not apply. In other words, the disposal will itself attract capital gains tax and the market value of the asset will be taxed once while computing capital gains under section 48 and the post-tax proceeds will be taxed again at the time of calculation of accreted income under section 115TD.

3.9 The definition of income in section 2(24) has not been amended to deem such accreted income as income.

3.10 Income-tax Act provides for taxation of income *qua* an assessment year and a previous year (see section 4). The tax on assets less liabilities cannot be said to be the income of a particular previous year.

However, it is pertinent that section 115TD(1) starts with a non obstante clause.

3.11 Non applicability of virtually all procedural provisions

- The tax is payable without any return of income (see para 3.11.1.)
- There is no provision for issue of notice for hearing or giving

opportunity of being heard to the assessee.

- There is no provision for assessment or issue of any order by the Assessing Authority. (also see para 3.11.2.)
- There is no provision for rectification.
- There is no express provision for issuing a notice on demand (please see para 3.11.3).
- There is no provision as to who will finally determine the correctness of the amount.
- There is no express provision for appeal to CIT(A) (please see para 3.11.4) or Tribunal or even High Court.
- There is no express provision for stay application and grant of stay (please see para 3.11.5).
- There is no express provision for refund (see para 3.11.6 below).
- There is no express provision for interest on refund, if the trust succeeds in an appeal before High Court or before Supreme Court.

Thus, the provision has virtually bypassed the entire Income-tax Act and singled out charitable institutions.

3.11.1 Return of income

There is no express provision. However, Form No. ITR-7, in which a return of income has to be filed by an institution contains provision for giving particulars under section 115TD (see Schedule 115TD in ITR-7).

The provision in the said form raises various questions. Is it required to be filled-up.

- in the year of cancellation?
- in the year in which tax is payable?
- by a charitable trust, whose registration is cancelled and is no longer enjoying exemption under section 11?

3.11.2 Order

There is no express provision in the Act for order by the AO.

However, in ***Genpact India (P.) Ltd. vs. DCIT, (2019) 108 taxmann.com 340 (Del.)***, in the context of section 115QA, the AO raised demand along with assessment order under section 143(3) of the Act. The Petitioner argued that the amount chargeable thereunder was in addition to the total income and, therefore, that portion of the impugned assessment order should be treated as a separate order against which no appeal was provided for under the Act. The High Court observed, on facts that the order was part of the assessment order, although, the demand under section 115QA would be in addition to the total income.

3.11.3 Notice of demand

A notice of demand shall be served upon an assessee if any tax, etc. is payable in consequence of any order passed under this Act (section 156). Now, in a case under section 115TD, no order is required to be passed and consequently section 156 regarding notice of demand is not applicable.

3.11.4 Appeal

Section 246A(1) provides that an assessee may appeal to the CIT(Appeals) against an order against the assessee where he denies his liability to be assessed under the Act.

On a plain reading, a charitable trust can file an appeal pursuant to this provision if

- there is an order under section 115TD; and
- the trust denies its liability to be assessed under the Act.

Now, there is no provision for issue of any order by the assessing authority. In such circumstances, it is unclear whether the letter or intimation through which the AO stipulates the sum payable under section 115TD(1) is an order for the purposes of section 246A(1)(a).

[However, in ***Genpact India Pvt. Ltd. vs. DCIT, Civil Appeal No. 8945 of 2019 (judgment dated 22-11-2019)***, the Supreme Court held that an appeal would be maintainable against the determination of liability under Section 115QA (tax on buy back of shares) under section 246A.

Similarly, in ***Cognizant Technology Solutions India Pvt. Ltd. vs. DCIT, W.A. Nos. 2063 of 2019 (Mad HC),*** the High Court held that an appeal under section 246A was maintainable against demand raised under section 115O of the Act.]

3.11.5 Stay application

Section 220(1) r.w. section 220(3) provides that any amount specified as payable in a notice of demand under section 156 shall be paid within 30 days of the service of the notice or within such extended time or such instalments as may be specified by the AO. Thus, the extension of time for payment is possible only if there is a notice of demand under section 156. Now, as explained in para 3.11.3, in case of section 115TD, there is no notice of demand and consequently, section 220(3) regarding extension of time for payment is also not applicable.

Section 220(6) provides for stay upon filing of appeal under section 246A. However, in case of section 115TD, there is no express provision for appeal under section 246A [unless the assessee successfully argues that is covered by section 246A (please see para 3.11.4 above)] and hence, the provision for stay under section 220(6) is also not applicable in case of section 115TD.

3.11.6 Refund

On a plain reading, section 237 is applicable only in respect of refund of tax in any assessment year. Now, tax on accreted income is not for any assessment year. Thus, there is no express provision for refund of accreted tax paid, even if it is held to be invalid and, the institution will have to take recourse to constitutional remedies rather than a specific remedy under the Income-tax Act.

However, see ***Torrent (P) Ltd. vs. CIT, (2013) 217 Taxman 149 (Guj)*** in which the High Court observed without giving any reasons that the refund of tax paid under section 115O was covered by section 237.

3.12 Taxation without accrual or arising or receipt

In the scheme of taxation of accreted income, there is no accrual or arising or receipt of income within the meaning of section 5. In the absence of such accrual or receipt, it is unclear as to what extent can the levy be sustained constitutionally.

However, it is pertinent that section 115TD(1) starts with a non-obstante clause.

3.13 Taxation without any ‘transaction’

There are many provisions in the Income-tax Act, which treat notional income as real income and proceed to tax the same (section 50C, section 43CA, etc.). All these

provisions seek to tax income of persons who have undertaken some transaction. In the case of accreted income, there is no transaction happening in the event of cancellation of registration or failure to obtain fresh registration or failure to transfer the assets within one year.

3.14 Tax is payable on virtually all assets

3.14.1 The following assets have to be ignored for the purpose of levying tax on accreted income.

- Any asset which is established to have been directly acquired by the institution out of its income of the nature referred to in section 10(1)
- Any asset acquired by the institution during the period beginning from the date of its creation/establishment and ending on the date from which the registration under section 12A/12AA became effective, if the institution has not been allowed any benefit of sections 11/12 during the said period.

[Proviso to section 115TD(2)]

3.14.2 The following assets would be liable to accreted tax:

- assets acquired out of non-agricultural income which was otherwise exempt under section 10 prior to insertion of section 11(7) (e.g. dividend income, etc.);
- assets acquired out of the basic accumulation of 15% of income under section 11(1)(a);
- assets acquired out of corpus donations exempt under section 11(1)(d);
- assets acquired out of bequests;
- assets acquired out of income below exemption limit;
- assets accumulated under section 11(2);
- **assets accumulated under section 11(2) but taxed under section 11(3);**
- **assets acquired out of business income on which tax was paid since it was not exempt under section 11(4A);**
- **assets acquired out of income taxed upon application of proviso to section 2(15);**
- **assets acquired out of income which suffered tax on account of application of section 13;**
- agricultural land gifted to the trust;
- **asset acquired out of anonymous donation taxed under section 115BBC;**
- **assets acquired out of income taxed under section 11, since it was not applied to the extent of 85% of income;**
- **assets acquired out of income taxed under section 11, since audit report was not filed under section 12AA(1)(b)**
- **assets acquired out of income taxed under section 11, since return of income was not filed within stipulated time [section 12AA(1)(ba)];**
- assets which have been treated as application of income towards charitable purposes (e.g., loans to poor, capital assets for attainment of

objectives of trust, say, equipment in a hospital);

Thus, the provision results in taxation of income which is already taxed (see highlighted portion above) or ought not be taxed. It completely negates the principle that broadly stated, all income may be charged with tax, but in the hands of the same person only once: See

- o ***Laxmipat Singhania vs. CIT, (1969) 72 ITR 291 (SC)***[1]
- ***o Jain Bros vs. UOI, (1970) 77 ITR 107 (SC)***

It is true that the Constitution does not contain any prohibition against double taxation as such and it is permissible if the Legislature distinctly enacts the same; but when there are general words of taxation, these should not be so interpreted as to tax the subject twice over to the same tax [***Ramanlal Madanlal vs. CIT, (1979) 116 ITR 657 (Cal); CIT vs. R. Dalmia, (1982) 135 ITR 346 (Del); CIT vs. B. R. Constructions, (1993) 202 ITR 222 (AP)***]. It is unclear whether it can be said that the legislature has distinctly enacted section 115TD, fully conscious of double taxation.

3.15 Tax could be much more than benefit obtained

Section 115TD taxes market value of asset, which could be much higher than the amount of exemption availed of. To illustrate, suppose an institution obtains a donation of ₹ 1 crore, which it utilizes to purchase land to be used for constructing a school building. Suppose it is liable to exit tax when the market value of land is ₹ 6 crore. In such a case, the institution would be liable to tax on ₹ 6 crore, although it availed of tax exemption of ₹ 1 crore only.

It is to be noted that in the Act itself, there are various provisions where a benefit given in the past is withdrawn on account of non-fulfilment of certain conditions. To illustrate, section 32A(5)(a) r.w. section 155(4A), (b) section 47A or (c) section 54F(3).

Even under the scheme of taxation of charitable trusts,

(a) if a trust does not utilise the full amount which has been deemed as application of income and given exemption in an earlier year under *Explanation* (2) to section 11, the exemption is withdrawn to the extent the income is not applied [section 11(1B)];

(b) amount exempt under section 11(2) is deemed to be income if the conditions of section 11(2) are not satisfied [section 11(3)].

In all the aforesaid cases, the taxation is to the extent of benefit obtained in the past. However, section 115TD is perhaps the only provision which taxes the market value of the asset, which could be much more than the amount of benefit/exemption obtained.

The taxation to the extent of market value of asset may make a registered charitable trust worse off than a charitable trust which is never registered under section 12A/12AA. Thus, in the illustration given above, an unregistered charitable trust could at the highest be taxed on ₹ 1 crore,

1. It is a fundamental rule of law of taxation that, unless otherwise expressly provided, an income cannot be taxed twice.

but the market value of its building of ₹ 6 crore will not be taxed (there is also a view that even when a charitable trust is not registered under section 12AA, the corpus donations received by it for specified purposes are not taxable at all[2]). However, a registered charitable trust covered by section 115TD could be taxed on ₹ 6 crore at MMR.

3.16 Tax is triggered on date of cancellation and not on date of default. If the date of default is prior to 1-6-2016, (the date on which Chapter XII-EB came into force), it may be argued that the law should not apply? See

- *"No person shall be convicted of any offence except for violation of a law in force at the time of the commission of that act charged as an offence, nor be subjected to a penalty greater than with which he might have been inflicted under the law in force at the time of the commission of the offence."*

  [Dayal Singh vs. State of Rajasthan, (2004) 5 SCC 721]

- "An increase in possible penalty is sufficient to make a statute *ex post facto* and invalid. An *ex post facto* law is one which renders an act punishable in a manner in which it was not punishable when committed. It alters the situation of a party to his disadvantage.

  [Chairman, CBDT vs. V. S. Malhotra, (1981) 128 ITR 543 (Del)]

3.17 In a way it also results in retrospective taxation. Suppose the institution commits a default in 2017 and its registration is cancelled. In such a case, it will have to pay tax on the total value of its assets including ₹ 25 crore, being the value of assets in respect of years during which the institution was fully compliant!

3.18 It is an avowed principle of equitable taxation that the penalty must correspond to the gravity of the offence [***UOI vs. A. Sanyasi Rao, (1996) 85 Taxman 321 (SC)***]. It is not clear whether this principle would be satisfied in all cases where tax on accreted income is triggered.

3.19 There is no *de minimus* clause. Hence, default of ₹ 1,000 can also trigger section 115TD, e.g., a trust having corpus of ₹ 10 crores, defaults under section 13(1)(d) by ₹ 1,000. In this case, the trust would be liable to section 115TD on ₹ 10 crores, which is much more than the default of ₹ 1,000.

3.20 Deemed

A fiction should be limited to the purpose for which it is enacted [see ***CIT vs. Mother India Refrigeration Industries (P.) Ltd., (1985) 155 ITR 711 (SC); CIT vs. Vadilal Lallubhai, (1972) 86 ITR 2 (SC); M. K. Balakrishnan Menon vs. Assistant Controller of Estate Duty-Cum-ITO, (1972) 83 ITR 162 (SC)***]. However, section 115TD(3) goes much beyond the purpose spelt out in the Memorandum.

Also, a fiction should not result in injustice [see ***CIT vs. Nathimal Gaya Lal, (1973) 89 ITR 190 (All)***].

2. ***ITO vs. Vokkaligara Sangha, (2015) 44 CCH 509 Bang. Trib.; ITO vs. Gaudiya Granth Anuved Trust, (2013) 28 ITR(Trib) 161 (Agra)*** confirmed by Delhi High Court [ITA No.9270 of 2009 dated 23-9-2003]; SLP dismissed [order dated 28-1-2013 passed in Civil Appeal No. 7036 of 2011]; ***Chandraprabhu Jain Swetamber Mandir vs. ACIT, (2017) 82 taxmann.com 245 (Mum. Trib).***

Tax under section 115TD(1) is on accreted income. The term 'accreted income' is defined in section 115TD(2) as "accreted income for the purpose of sub-section (1) means". The definition is not even 'deemed'. It is a must point as to whether such artificial meaning be given to a word to tax something which in no rational sense can be considered as income.

3.21 All liabilities may not be deductible

Rule 17CB(3) provides that only book value of liabilities in the balance sheet shall be considered as liability. Further, provision for taxation shall not be allowable except to the extent provided in rule 17CB(3B). Hence, it appears that any liability not provided in the books or exit tax liability may not be regarded as liability for the purposes of section 115TD, unlike wealth-tax, where unprovided liability or unprovided liability or even wealth-tax liability itself was regarded as a debt owed [see ***Kesoram Industries & Cotton Mills Ltd. vs. CWT, (1966) 59 ITR 767 (SC); Assam Oil Co. Ltd. vs. CWT, (1973) 91 ITR 22 (SC)***].

3.22 Valuation concerns under Rule 17CB:

3.22.1 The rule refers to "aggregate of the fair market value of all the assets in the balance sheet" [Rule 17CB(1)]. However, the definition of accreted income excludes certain assets (see para 3.14.1):

It appears that rule 17CB will have to be read down and made applicable to only those assets which are not excluded as aforesaid by section 115TD(2).

3.22.2 Unquoted equity shares:

Rule 17CB(2)(I)(b) provides for computation of FMV of unquoted equity shares held by the institution. Certain issues arise from this rule-

- The FMV of unquoted equity shares is to be computed on the basis of the balance sheet on the specified date. However, if the specified date is other than 31st March, the company may not draw up a balance sheet on that day. In such circumstances, it is not clear how a trust which is a mere shareholder in the company can compel the company to draw up a balance sheet on the specified day. Further, the law is also silent as to whether the balance sheet as on 31st March preceding or succeeding the specified date can be used.

- Unquoted equity shares are not to be valued at book value. The individual assets of the company will have to be examined and certain assets such as bullion, shares securities, immovable properties etc. will have to be valued in accordance with the rules.

  To illustrate, if the company is owning immovable property whose cost is 50 lakh and fair market value is 1.5 crore then, a sum of ₹ 1.5 crore will have to be substituted for ₹ 50 lakh, in order to compute the FMV. This provision may create huge difficulties in valuation:

  Suppose, the trust is holding only 1% of the equity shares, how will it compel the company to give the valuation of individual assets? If the investee company is owning unquoted equity shares then, those unquoted equity shares will also have to be valued in accordance with the rule!

  To illustrate, suppose a trust is owning shares in company "A" and company "A" is owning shares in company "B". In this situation, for the purpose of

valuation of shares in company "A", the fair market value of the shares in company "B" will be needed. Now, the valuation of shares in company "B" is also to be determined in the manner provided in the rules and hence, it will have to be ascertained whether company "B" holds assets such as bullion, immovable properties, etc. and if it owns such assets, then, these have to be valued at fair market value!!

- No discounting for lack of marketability is provided in the Rules. This is contrary to the well-established principle of valuation that discount has to be provided for non-negotiability [See ***Bharat Hari Singhania vs. CWT, (1994) 207 ITR 1 (SC); CWT vs. Mahadeo Jalan, (1972) 86 ITR 621 (SC)***]. Further, this principle of discounting was also accepted in erstwhile rule 1D of the Wealth-tax Rules, 1957.

3.22.3 Immovable property:

Stamp duty valuation is higher. This concept of higher of the two has not been adopted in any other place in the Act.

To illustrate, section 50C (dealing with computation of capital gains upon transfer of immovable property) uses three concepts:

- declared consideration;
- stamp duty value; and
- value as per registered valuer.

The section provides that capital gains shall be chargeable on declared consideration, if such consideration is higher than stamp duty value. However, if the declared consideration is lower than the stamp duty value, then, capital gains shall be chargeable on the stamp duty value. In such a case, even if the FMV as per registered valuer is higher than the stamp duty value, capital gains tax shall be payable on stamp duty value [section 50C(3)].

Thus, if the institution transfers the immovable property (and actually receives consideration), at the highest, it could be liable to capital gains on stamp duty value. However, if for some reason, it is subject to exit tax (where it does not receive any consideration), it would be liable to tax on higher of stamp duty value and fair market value as per registered valuer!

Further, immediately after cancellation of registration, if the institution transfers the immovable property, it will not be liable to tax on fair value even if it is higher than stamp duty value! (as long as the recorded consideration is less than the fair value).

It is submitted that although the FMV has to be computed in accordance with rules, the rules cannot prescribe a method which yields an amount even higher than the fair market value (FMV).

Further, the fact that the Rules framed under the Act have to be laid before each House of Parliament would not confer validity on a Rule if it is made not in conformity with the Act [***Hukam Chand vs. UOI, Air 1972 SC 2427; Lohia Machines Ltd. vs. UOI, (1985) 152 ITR 308 (SC); Bharat Hari Singhania vs. CWT, (1994) 207 ITR 1 (SC)***].

FMV represents the price that a seller is willing to accept and a buyer is willing to pay in the open market.

Thus, to the extent, the rule stipulates price that the property shall ordinarily fetch if sold in the open market, it is submitted that this figure represents the FMV of the asset. In the circumstances, if the stamp duty valuation is higher, it appears that such valuation would be higher than the FMV and such higher value goes beyond the Act, which requires payment of tax on FMV. In view of the above, it could be argued that rule 17CB(2)(II)(b) is *ultra vires* the Act.

3.22.4 It is not that all quoted shares are covered by rule 17CB. There is a specific definition in *Explanation* (d) to Rule 17CB and hence, a share will be covered only if the following conditions are fulfilled:

- The share is quoted on a recognized stock exchange;
- The share is quoted with regularity from time-to-time;
- The quotation of the share is based on current transaction;
- The current transaction is made in the ordinary course of business.

3.23 Violation of FCRA or contractual terms

It is possible that the institution is subject to other laws or contractual terms, which have imposed restrictions on utilisation of the assets. To illustrate, the foreign contribution received by an institution can be utilized only for specified purposes. A grant received by an institution can be utilized only in accordance with the purposes specified by the donor. On a literal reading, all these assets would be subject to the accreted income tax. Further, in order to meet the liability, they may have to be liquidated in violation of the purposes specified under FCRA or under the grant agreement. This would all trigger further penal consequences.

3.24 Penalty, waiver of

Section 270AA confers power on the AO to grant immunity from penalty. Section 273A gives discretion to the Commissioner of Income tax to waive any penalty. Both these provisions mitigate hardship caused by penalty even on a serious offence such as concealment. However, no such power is granted in respect of accreted tax.

3.25 Finance Minister's (FM)'s speech:

The relevant portion of FM's speech is reproduced below:

"… where a trust or institution registered u/s 12AA of the Income-tax Act **ceases to be charitable organisation**, the amount of net asset as on date of such conversion which represents the income accreted to the trust **over a period of time** shall be charged to additional income-tax at the maximum marginal rate."

The Finance Minister stated that section 115TD is introduced to cover a trust registered under section 12AA and which "ceases to be charitable organisation".

Further, the tax is payable on amount of net asset as on the date of conversion which represents the income accreted to the trust over a period of time.

Now, suppose a trust, whose only default is that it continues to hold shares in violation of section 13, can it be argued that section 115TD is not applicable to the trust in question since they have not ceased to be a charitable trust?

Further, the speech refers to the date of such conversion but does not refer to cancellation of registration.

Again, the speech refers to the income accreted to the trust over a period of time.

Does this suggest that what is proposed to be withdrawn is the income accruing/received by the Trust over a period of time and not the market value of the asset and hence, tax should be levied on exemption obtained and not on the market value of the asset?

3.26 Memorandum/CBDT Circular explaining the relevant provisions of the Finance Bill/Act ("Memorandum").

A perusal of the text of the Memorandum shows the following:

- The Memorandum refers to a trust which may convert into a non-charitable organisation.
- According to the Memorandum, the purpose behind insertion of section 115TD is
  - o to act as a deterrent to a trust from converting itself into a non-charitable organisation;
  - o to ensure that trust which built-up corpus and asset base with promise of it being used for charitable purpose continues to be utilised for charitable purposes and is not used for any other purpose; and
  - o to avoid transfer of assets to a non-charitable institution.
- It is significant that nowhere does the Memorandum refer to application of section 115TD upon cancellation of registration, whereas on 5 occasions, it refers to a trust which may convert into a non-charitable form.

  While section 115TD(2) does define 'conversion' into a form as including cancellation of registration, but the omission of cancellation of registration in the Memorandum is significant. Does it mean that section 115TD should apply to a trust which converts into a non-charitable organisation as normally understood?
- A trust would not be registered unless the objects are charitable. Ordinarily, they are good evidence of the objects continuing as charitable [see ***Hiralal Bhagwati vs. CIT, (2000) 246 ITR 188 (Guj.) approved by the Supreme Court in ACIT vs. Surat City Gymkhana, (2008) 300 ITR 214 (SC)***].

  However, cancellation can happen even when the objects remain charitable and entire income is spent on charitable purpose [say, upon violation of section 13(1)(d)].

  In such circumstances, how can it be said that the trust has become non-charitable as mentioned in the Memorandum?
- The Memorandum states that the amendment is intended to plug the gap in law, that allows the charitable trust having built-up corpus/wealth through exemptions being converted into non-charitable organisation. Does this suggest that what is proposed to be withdrawn is the exemption obtained and not the market value of the asset and hence, tax should be levied on exemption obtained and not on the market value of the asset?

3.27 General:

While individually one may be able to contend that the Memorandum or the circular or the Finance Minister's speech is not binding, it can be said that

collectively, when none of them states that section 115TD could apply in case of a cancellation, and all of them state that the purpose is to tax a trust which ceases to be a charitable organisation or converts into a non-charitable organisation, the provision should not be applied to an institution which has merely violated section 13 but has never ceased to be charitable.

In the alternative, their language does help in reading down the provision in some manner as applicable to a trust whose registration is cancelled on account of-

- its activities not being genuine,
- its activities are outside its objects,
- its activities result in benefit to interested parties under section 13(1)(c) r.w. section 13(2).

3.28 Constitutional validity and 'reading down' of the provisions in Chapter XII-B

- At various places, the section refers to accreted income. Thus,
  - o Section 115TD(1) refers to the tax as tax on accreted 'income' of the trust.
  - o The marginal note states that the provision is in respect of tax on accreted 'income'.
  - o The chapter heading is "special provisions relating to tax on accreted 'income' of certain trusts and institutions".

  The use of the word 'income' is significant. It suggests that the tax is meant to be on income of the trust. Again, section 115TD(1) states that the accreted income … shall be charged to 'tax'. Tax has been defined in section 2(43) of the Act as income tax chargeable under the provisions of the Act. Further, section 115TD(6) refers to tax 'in respect of the said income'. Thus, the tax on accreted income is clearly purported to be is a tax on income.

  Finally, section 115TD(7) refers to 'income' which has been charged to tax. It is very significant that here the word 'accreted' is conspicuously absent. It is therefore submitted that the word 'income' in section 115TD(7) refers to 'income' as normally understood under section 2(24) and the tax under section 115TD(1) is meant to be a tax on income as normally understood. It is unclear whether

  - o a tax can be said to be tax on income, when nothing comes in which is the normal connotation of income;
  - o unrealised appreciation in value of assets can be regarded as income; and
  - o to the extent section 115TD is levying tax beyond 'income' of the trust, it is constitutionally valid.

  It appears that the tax on accreted income has to satisfy that it is a tax on income under Entry 82 in List I of the Schedule VII to the Constitution of India. For this purpose, while the word 'income' should be construed liberally and in a very wide manner and the power to legislate will take in all incidental and ancillary matters, including the authorisation of to make provision to prevent evasion of tax, in any suitable manner [***UOI vs. A. Sanyasi Rao, (1996) 219 ITR 330***

(SC); Punjab Distilling Industries vs. CIT, AIR 1965 SC 1862], the doctrine of liberal interpretation does not mean that Parliament can choose to tax as income an item which is no rational sense can be regarded as a citizen's 'income' [***Navnit Lal C. Javeri vs. ACIT, (1965) 56 ITR 198 (SC)***].

Again in ***Chelmsford Club vs. CIT, (2000) 243 ITR 89 (SC),*** the Supreme Court had to overrule ***CIT vs. Wheeler Club Ltd., (1963) 49 ITR 52 (All.)***, where the High Court had held that taxation on income of house property is a tax on property and not income tax. The Supreme Court held that *"the legislative competence to levy income-tax is traceable to Entry 82 of List I of Schedule VII to the Constitution which reads : "Taxes on income other than agricultural income". Therefore, any law made under this legislative entry can impose a tax only on income and not under any other head, there is also no dispute that the Act is a law made under this entry."*

Thus, the Supreme Court has clearly held that the tax on property cannot be levied as income-tax.

It is evident that the accreted tax is on assets. In fact, the tax is payable on market value of assets without reduction of cost of acquisition! It could be argued that in no rational sense can this be regarded as income. That is precisely the reason why the Constitution of India has a separate Entry 86, List I in Schedule VII for levy of tax on capital value of assets. Further, it cannot be said that all charitable institutions which propose to merge with another charitable institution (especially when the other institution is registered under section 12A or section 12AA) or assessee failing to transfer the assets within one year of dissolution [especially those transferring to institutions covered under section 12A or section 12A or 10(23C)(iiiab) to (iiiae)] or trusts whose registration is cancelled are assessees indulging in evasion of tax.

On the other hand, one has to consider Entries 86 and 97 of List I of Schedule VII of the Constitution support section 115TD, even if it be held that it does not fall within Entry 82.

Further, "charities and charitable institutions, charitable and religious endowments and religious institutions" find place in Entry 28 of List III of Schedule VII, the Concurrent List. Therefore, can section 115TD be treated as one regulating charities, and hence, not beyond Parliament's powers?

Some other constitutional issues are

o Could it be urged that section 115TD read with rule 17CB is confiscatory of the assets and that the provisions do not in fact provide for a tax on the accreted income? Will this be a factual exercise to be determined in the facts of a given case?

  Please see ***Sulochana Enterprises vs. UOI, (1991) 56 E.L.T. 22 (Mad.)*** [excessive tax should amount to confiscatory in order to be violative of Article 19(1)(g)].

- o Could it be urged that the provision is arbitrary so that it violates Article 14?

- Doctrine of reading down

  In several cases Courts have invoked and applied the doctrine of 'reading down' to sustain the constitutionality of a provision. Essentially, the Court will not read the provision literally but will construe it in a more limited sense or will read some condition into it to retain the constitutionality [***Arun Kumar vs. UOI, (2006) 155 Taxman 659 (SC); C. B. Gautam v. UOI, (1993) 199 ITR 530 (SC)***].

  In view of the above and other points mentioned in the aforesaid paragraphs, it is unclear as to whether the provision is constitutionally valid in all situations covered by the provisions in section 115TD or whether the Courts will apply the doctrine of reading down and construe it in a sense other than literal sense.

3.29 Principles of natural justice

In ***C. B. Gautam vs. UOI, (1992) 65 Taxman 440 (SC),*** the Supreme Court has held that observance of principles of natural justice is *sine qua non* for any valid legislation. Now, under Chapter XII-EB, there is no provision requiring observance of principles of natural justice (see para 3 above) and in the circumstances, can the provisions be challenged applying the principle laid down by the Supreme Court? Can it be considered that these requirements may be read in, having regard to the judicial precedents aforesaid?

Attention is also invited to the following decisions:

- ***Kunnathat Thathunni Moopil Nair vs. The State of Kerala, (1961) 3 SCR 77:***

  Where the procedure laid down in a taxing statute is opposed to rules of natural justice, then any imposition of tax under such a procedure must be held to violate Article 19(1)(f) (now deleted from the Constitution).

- ***Ujjam Bai vs. State of Uttar Pradesh, AIR 1962 SC 1621***: the considerations applicable to Articles 19(1)(f) and 19(1)(g) are the same.

4. Conclusion

Chapter XII-EB has a number of interpretational issues. It is perhaps the only provision which taxes the market value of the asset, which could be much more than the amount of benefit obtained by institution. This may make a registered institution worse off than a trust which is never registered under section 12A/12AA. Further, the provision completely ignores the established tax principle that income may be taxed in the hands of the same person only once. The Chapter also virtually bypasses the entire Income-tax Act (especially the procedural provisions) and singles out institutions.

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Critical Analysis of Applicability of GST

CA Sunil Gabhawalla

1. Introduction

1.1. The imposition of taxes on charitable trusts has always been a bone of contention. While social considerations would suggest that such charities should be kept outside the purview of taxes, the possibility of misuse and revenue consideration forces Governments to grant exemptions but cautiously (with many conditions and checks and balances).

1.2. In the context of indirect taxes like GST, the policy narrative becomes even more diluted since the person effectively bearing the tax is not the charitable trust itself but the consumer of the goods or services supplied by the trust. In fact at times, an exemption or an exclusion can be counter-intuitive and may result in cascading effect due to denial of input tax credit.

1.3. Having said so, most of the charitable trusts may not be geared up to comply with the onerous documentation and filing requirements under GST. At times, when this crystal-maze of compliance obligations is also coupled by over-zealous stretched interpretations of taxability (like demanding tax on donations), the situation could be frustrating and impact the long-term growth of this sector.

1.4. In the above background, this article presents a perspective on the provisions relating to applicability of GST to such charitable trusts.

2. Is GST Law applicable to charitable trusts at all?

2.1. At the outset, it may be important to discuss whether the GST law[1] applies to charitable trusts at all. Section 1 of the CGST Act, 2017 states the applicability of the law to the whole of India. Section 22 obliges every 'supplier' to register (and consequently comply with the provisions of the law) if the supplier crosses the prescribed threshold (generally an aggregate turnover exceeding ₹ 20 lakhs). The term 'supplier' is defined

1. In view of the dual GST model adopted in India, the GST Law consists of the CGST, SGST, UTGST, IGST and Compensation Acts as well as Rules prescribed each of the said enactments. Since the provisions are similarly worded across various enactments, the current article refers to the provisions of the CGST Act, 2017 and the references need to be read mutatis mutandis for other enactments.

under Section 2(105) to mean the 'person' supplying the said goods or services. In turn, the term 'person' is defined under Section 2(84) in an inclusive manner to inter alia include a trust.

2.2. The sum and substance of the rather long circuitous route of legal provisions referred to above is that there is really no outright exclusion for charitable trusts from the applicability of the provisions of the GST Law. Entry 26 of Notification 12/2017-CT grants an outright exemption for all services provided by the Reserve Bank of India. There is no such blanket exemption for all services rendered by charitable trusts. As such, the law would apply to a charitable trust, just as it would apply to any other commercial concern.

2.3. However, the applicability of a tax needs to be understood not only from the perspective of applicability of the law to a person but from the perspective of the applicability of the tax to the subject matter of taxation. Indeed, the levy provisions have to be triggered and only if such levy provisions are triggered, does one go and identify the subject (person) who is required to comply with the said levy provisions and the associated obligations.

2.4. Article 366(12A) of the Constitution of India, the preamble to each of the GST Laws and Section 9(1) of the CGST Act, 2017 leave no place for doubt that the levy of GST is on supplies of goods or services or both. Therefore, it is very important for charitable trusts (or for that matter, every person) to examine whether the levy provisions are triggered in the facts of their case or not.

2.5. To cite an example, an investment company is admittedly formed 'for profit' purposes and may not have any charitable objectives in mind. However, if the only activities undertaken by it pertain to purchase and sale of securities, the levy provisions are not triggered since securities are excluded from the definition of goods as well as services. In such a case, the investment company may not require a registration. If the investment company has some activity like consultancy services rendered by it, it would then need a registration but the levy provisions would trigger only *vis-à-vis* such consultancy services and not *vis-à-vis* the entire spectrum of purchase and sale of securities.

2.6. Similar to the above example, it may be important to identify the activities carried out by a charitable trust and then critically examine each such activity to see whether the same can be considered as a supply of goods or services or both. However, before embarking on such fact-finding mission, it may be relevant to have an understanding of the 'scope of supply' as provided under the GST Law.

3. Scope of Supply

3.1. The term 'supply' has not been defined under the GST Law. Therefore, the said term may have to take colour from the general understanding thereof. However, it is important to note that Section 7 of the CGST Act, 2017 delineates the scope of supply for the purposes of the Act. Therefore, irrespective of the general notions of the term supply, the levy is restricted to the scope of supply prescribed under Section 7[2]. In the present context,

2. Though Section 7(1) specifies that the scope 'includes' activities listed thereafter, the said word will have to be interpreted as 'means' in the context of the said provision listing out the scope of supply rather than providing a definition of the term 'supply'. If such contextual interpretation is not given, many anomalous positions may emerge.

sub clause (a) of Section 7(1) listing out the primary scope of 'supply' is relevant and is reproduced below for ready reference:

> *7(1) For the purposes of this Act, the expression "supply" includes*
>
> *(a) **all forms of supply** of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal **made or agreed to be made for a consideration** by a person **in the course or furtherance of business***

3.2. On a perusal of the above provision, it is evident that there are many essential ingredients for coverage of a particular supply within the scope of the GST Law. The important ingredients are listed below for ready reference:

i. All forms of supply of goods or services or both

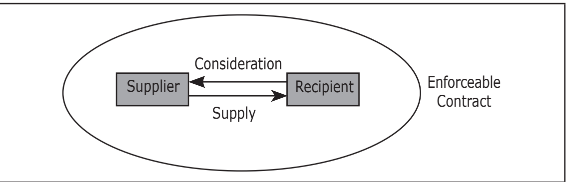
ii. The supply should be made or agreed to be made

iii. The supply should be for a consideration

iv. The supply should be in the course or furtherance of business

3.3. The existence of the phrase "made or agreed to be made' along with the requirement of consideration clearly suggest that the supply should emanate out of an enforceable contract between two willing and consenting parties. Such an interpretation was also a settled legal proposition under the erstwhile transaction driven indirect taxes like value added tax and service tax.

3.4. Apart from the last pre-requisite of the supply to be in the course or furtherance of business (which is discussed in detail later), it is evident that for a supply to fall under the scope of GST, the same has to emanate out of an enforceable contract between two consenting parties and should contain a supply made by one of the parties to another in return for a consideration to be paid by the other party to the first one. Pictorially, this can be represented by means of a diagram as under:



4. GST Implications on donations received by a Charitable Trust

4.1. While the above discussion explains the legal matrix for considering a transaction as a supply, it is found that at a practical level, one tends to look at receipts or incomes, 'presumes' that such receipts or incomes tantamount to consideration, resulting in further 'presumption' that the consideration has to be against some 'presumed' supply and perhaps totally ignore the requirement of an enforceable contract being the perimeter of the entire tax liability. In such scenario, one may perhaps arrive at a flawed interpretation of taxability (where there is none) and it may be easy to justify the same on the grounds of conservatism. It is by now a settled proposition of law that the tax cannot be demanded merely on presumptions. Before demanding a tax, the burden of proving the existence of a supply lies on the Department.

4.2. On a regular basis, queries are raised on whether donations attract GST or not. In view of such queries, the CBIC[3] has clarified recently as under:

3. Circular 116/2019-GST dated 11.10.2019

Individual donors provide financial help or any other support in the form of donation or gift to institutions such as religious institutions, charitable organisations, schools, hospitals, orphanages, old age homes etc. The recipient institutions place a name plate or similar such acknowledgement in their premises to express the gratitude. When the name of the donor is displayed in recipient institution premises, in such a manner, which can be said to be an expression of gratitude and public recognition of donor's act of philanthropy and is not aimed at giving publicity to the donor in such manner that it would be an advertising or promotion of his business, then it can be said that there is no supply of service for a consideration (in the form of donation). There is no obligation(quid pro quo) on part of recipient of the donation or gift to do anything (supply a service). Therefore, there is no GST liability on such consideration

4.3. While the above clarification does provide substantial relief to the charitable trusts as well as the donors and it does accept the requirement of a supply as well as a quid pro quo for the said supply, it brings in a bit of confusion by highlighting the philanthropic and non-commercial nature of the acknowledgement of the donation. It is felt that the purpose/end result of the acknowledgement of the name of the donor may not be the most important criteria to determine the existence of a supply and the nexus of the donation towards a supply. For example, if the amount is donated by a company, the acknowledgement may mention the name of the company. This by itself does not mean that the trust provides advertisement service to the company. In all probabilities, the donation is acknowledged at a place where the company really does not have a target audience at all !

4.4. It is therefore felt that a donation made to a charitable trust which is not consequent or as a *quid pro quo* for a service/supply, cannot be made liable for GST. Even if there are some voluntary actions of gratitude undertaken by the trust (like orphanage acknowledging the name of the donor or hospital providing priority treatment to patients recommended by the donor), such actions do not constitute supply and therefore GST could not be demanded.

4.5. In case of corpus donations, the donee makes the donation with a specific purpose or stipulation about the end use of the funds. For example, a donee may donate a huge sum to a charitable trust with a specific condition that the funds will be used only for the purposes of construction of a library. The question to ask is what is the supply made by the charitable trust and whether the corpus donation is a consideration for such supply? The answer is clearly in the negative.

4.6. Having said so, merely the nomenclature of 'donation' does not by itself conclusively mean that GST is not payable. In the context of service tax also, there were cases where a trust would rent out its' premises for a day and collect donations. Such donations were essentially quid pro quo and hence held to be liable for service tax[4]. While observations in the said decision may apply under GST as well, the additional requirement for the supply to be in the furtherance of business may change the end-answers under GST.

4. *CCE vs. Shri Kutch Kadva Patidar Samaj 2015 (39) STR 160 (Mumbai Trib)*

5. GST Implications on Subsidies, Grants & CSR Funding

5.1. The insignificance of the nomenclature of the payment and the requirement of a nexus between a supply and the payment for the said supply results in substantial confusion in determining the line of divide between taxability and non taxability in certain cases.

5.2. Whether grants could be treated as a consideration for the rendition of some service has been a subject matter of litigation under the service tax regime as well. The Education Guide nicely clarifies the thin line of divide in this regard:

2.2.2 What are the implications of the condition that activity should be carried out for a 'consideration'?

- *To be taxable an activity should be carried out by a person for a 'consideration'.*
- *Activity carried out without any consideration like donations, gifts or free charities are therefore outside the ambit of service. For example grants given for a research where the researcher is under no obligation to carry out a particular research would not be a consideration for such research.*
- *An act by a charity for consideration would be a service and taxable unless otherwise exempted. (for exemptions to charities please see Guidance Note 7)*
- *Conditions in a grant stipulating merely proper usage of funds and furnishing of account also will not result in making it a provision of service.*
- *Donations to a charitable organization are not consideration unless charity is obligated to provide something in return e.g. display or advertise the name of the donor in a specified manner or such that it gives a desired advantage to the donor.*

.....

2.2.7 Are research grant with counter obligation on researcher to provide IPR rights on outcome of a research a consideration?

In case research grant is given with counter obligation on the researcher to provide IPR rights on the outcome of research or activity undertaken with the help of such grants then the grant is a consideration for the provision of service of research. General grants for researches will not amount to a consideration

5.3. The above principles would be helpful in the GST Regime as well. In the context of GST, Section 2(31) defining consideration specifically excludes subsidies given by the Central Government or the State Government and accordingly, no GST is attracted on such subsidies

5.4. In one of the early decisions under the service tax law, the Tribunal[5] nicely explains the concept and pre-requisites for taxability of grants and subsidies received. In the said case, the Appellant was involved as an Implementation Partner for the implementation of welfare schemes announced by the Government. The Department raised a demand of Service tax on grants-in-aid received from government

5. *Apitco Limited vs. CST 2010 (20) S.T.R. 475 (Tri.-Bang.). Revenue Appeal to the Supreme Court dismissed vide Commissioner vs. Apitco Ltd. 2011 (23) S.T.R. J94 (S.C.)*

for implementation of welfare schemes. It was not disputed that the appellant was assisting the Government in the implementation of welfare schemes of Central and State Governments for poor and weaker sections on collection of grants-in-aid. It was held that the grants-in-aid were fully utilized for said activity and no consideration received for any service to government since the service provider-client relationship between appellant and government was absent. The mere existence of an activity of execution of schemes through engineers or technocrats along with receipt of grant-in-aid was not sufficient to establish a quid pro quo and for coverage under relevant service.

5.5. However, in another recent case[6] where an entity received provided training services to doctors and received partial fees from the doctors and the balance was provided as grant by the pharmaceutical companies, it was held that the law did not require that the consideration should flow only from the recipient of the service and accordingly it was held that such grants were in essence in the nature of consideration and therefore liable for payment of service tax.

5.6. In an advance ruling application filed by Indian Institute of Corporate Affairs[7], the Authority was requested to determine the tax implications of the receipt of grants by an entity implementing the CSR obligations of a corporate through the execution of social welfare assignment of construction of toilets in rural areas. The Advance Ruling Authority, without establishing the nexus of the grant, proceeded to treat the same as a consideration received for the rendition of service from a third party and accordingly held that the same is liable for GST.

5.7. It is felt that there is a fundamental difference in the facts of the two cases reported above. In the case of the entity providing training services to doctors, there is clearly a service provider – service recipient relationship between the entity and the doctor and it is only partial consideration which is paid by the pharmaceutical company. However, in the case of IICA, there is really no element of service between IICA and the beneficiary of the toilet in the rural areas. In fact, there is really no identified service recipient at all and therefore, without establishing the service recipient or the service, directly interpreting the concept of consideration is like placing the cart before the horse.

5.8. The above principles could guide a charitable trust in determining whether the donations or grants or CSR Contributions received by it could be treated as consideration for a supply or not. In cases where either a discernible supply cannot be identified or an inextricable nexus between the donation or grant or CSR Contribution cannot be established, GST would not be attracted.

6. Supply should be in the course or furtherance of business

6.1. In continuation of the above discussion, in cases where such a nexus can indeed be established, the transaction could constitute a supply in general parlance. However, as already stated earlier, it is important that the said supply should be included in the scope of supply for the purposes of GST. One important

6. *Public Health Foundation India vs. CST 2019 (20) G.S.T.L. 576 (Tri.-Del.)*

7. 2019-TIOL-242-AAR-GST

requirement for inclusion of an activity or transaction in the scope of supply for GST is that the supply should be in the course or furtherance of business. At the cost of repetition, Section 7(1)(a) is reproduced once again for ready reference:

7(1) For the purposes of this Act, the expression "supply" includes

*(a) **<u>all forms of supply</u>** .... by a person **<u>in the course or furtherance of business</u>***

6.2. The above provision clearly restricts the scope of supply for the purposes of GST only to those supplies which are in the course or furtherance of business. This fundamental concept is very clearly brought out in the Press Release[8] issued by the CBIC in the context of reverse charge mechanism and the relevant portion is quoted below for ready reference:

Even though the sale of old gold by an individual is for a consideration, it cannot be said to be in the course or furtherance of his business (as selling old gold jewellery is not the business of the said individual), and hence does not qualify to be a supply per se.

6.3. The term business has been defined in an inclusive manner in section 2(17) of the CGST Act to include the following activities:

a) *Any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit*

b) *Any activity or transaction in connection with or incidental or ancilliary to sub-clause (a)*

c) *Any activity or transaction in the nature of sub-clause (a), whether or not there is volume, frequency, continuity or regularity of such transaction*

d) *Supply or acquisition of goods including capital goods and services in connection with commencement or closure of business;*

e) *provision by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its members;*

f) *admission, for a consideration, of persons to any premises;*

g) *services supplied by a person as the holder of an office which has been accepted by him in the course or furtherance of his trade, profession or vocation;*

h) *services provided by a race club by way of totalisator or a licence to book maker in such club; and*

i) *any activity or transaction undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities.*

6.4. A very elaborate definition of business provided under the Statute may lead one to wonder whether such an elaborate definition may permit us to draw any boundaries on taxability of supplies under Section 7(1)(a). Is the use of the phrase "in the course or furtherance of business" in Section 7(1)(a) only to exclude supplies undertaken in personal capacity or does it really restrict the scope only to activities carried out by commercial / pseudo-commercial entities. To put it in the context, just like an individual selling

8. 78/2017 dated 13-7-2017

jewellery cannot be called upon to pay GST, but a commercial concern selling jewellery is liable for GST, can a religious trust selling ornaments gifted by the devotees be called upon to pay GST?

6.5. A brief history of the said definition may assist us in this understanding. Historically, the term business was not included in the list of definitions under the Central Sales Tax Act and other General Sales tax legislation. It was in 1959 where the Madras General Sales Tax Act defined this term to include trade, commerce, etc within its ambit. The definition has evolved over time and attempted to overcome certain infirmities identified by judicial decisions. It would be very interesting to note that the Courts have not given an unlimited space to this term even-though the said term was defined in any inclusive manner.

6.6. The Central Sales Tax Act, 1956 had defined the said term as follows:

"'business' includes,

(i) Any trade, commerce, manufacture or an adventure or concern in the nature of trade, commerce or manufacture, whether or not such trade, commerce, manufacture, adventure or concern is carried on with a motive to make gain or profit and whether or not any gain or profit accrues from such trade, commerce, manufacture, adventure or concern; and

(ii) Any transaction in connection with, or incidental or ancillary to, such trade, commerce, manufacture, adventure or concern"

6.7. The above definition is similar, in terms of coverage, to clause (a) and (b) of section 2(17) of the GST Law. In a landmark decision, the Supreme Court[9] held that the expression "business" though extensively used as a word of indefinite import, in taxing statutes it is used in the sense of an occupation, or profession which occupies the time, attention and labour of a person, normally with the object of making profit. To regard an activity as business there must be a course of dealings, either actually continued or contemplated to be continued with a profit motive, and not for sport or pleasure.

6.8. In another decision (prior to the insertion of expansive clauses of incidental/ ancillary activity) the Hon'ble Supreme Court[10] examined whether discarded machinery, sale of waste, scrap or unserviceable material fall within the scope of the term 'business'. The assessee contended that it was not engaged in buying and/or selling of such material and the said material was not sold with an objective of profit. The Court observed that the term 'business' does not hinge solely on the motive of earning profit though it predicates a motive which pervades a whole series of transactions effected by the person. The Court further observed that though the volume and frequency of the transaction was high, the taxable person cannot be said to have had the intention of carrying on business of such items. Though the residuary price may impact the profit and loss account by reducing the costs, that does not by itself establish an intention to carry on business in that product. In the same judgement, the Court also held that sale of by-products (caustic liquor) was an incident of the manufacturing activity of the Company and was includible in the

9. *State of Andhra Pradesh vs. Abdul Bakhi And Bros [1964] 15 STC 644 (SC)*
10. Raipur Manufacturing Co. Ltd. ([1967] 19 STC 1 (SC))

definition of business under the Bombay Sales Tax Act under the primary clause itself.

6.9. Subsequently, in the post amendment period, the Hon'ble Supreme Court[11] settled some conflicting High Court decisions and held that the amendment in 1964 has made the *intention of profit as an unnecessary criteria* not only to the primary clause but also to the secondary clause of the definition of business. In view of this canteen sales, sales of advertisement materials and scrap sales were held to be taxable under the post amendment period even if they were not conducted with the object of making profit.

6.10. In another interesting landmark decision, the Supreme Court[12] was examining the taxability of sale of uncleared or abandoned items by a Port established under a statute performing statutory functions without any objective of making profit. It was held that if the main activity was not business then any connected or incidental activity of sales would not amount to business unless an independent intention to conduct business in these connected activities is established. In this backdrop, the Court held that Port Trust was not engaged in business and hence the activity of sale of uncleared or abandoned items cannot be termed as a business activity.

6.11. In one of the relatively recent decisions, the Supreme Court[13] reiterated that the Sale of publications and prasadam by a temple does not constitute business even if there is a profit motive

6.12. In the background of the above legislative and judicial history, the current definition of business needs to be analysed. The first clause (a) of the definition is the bedrock on which most of the clauses of definition rest upon. Except for the inclusion of profession, vocation, adventure, wager, etc, the said clause is more or less similar to the definition of the business in the central sales tax and state sales tax statutes. The clause should be understood in a commercial sense (as understood by the Supreme Court in Abdul Bakshi's case supra) except for the requirement of a profit motive, which is analysed later.

6.13. Clause (b) of the definition of business includes activities which are incidental to the primary business activity. The said clause emphatically requires that the primary activity should be in the nature of business for the incidental activity to also be included in the definition. This is in line with the principles laid down by the Madras Port Trust's case where the primary activity of the Trust was of non-business character. As rightly pointed out in the decision, this conclusion should be reached only after ensuring that the incidental activity should not be an independent activity to fall within the first clause itself

6.14. Clause (c)makes the frequency, continuity or regularity of the primary activity as irrelevant in deciding whether the activity is in the nature of business, in other words occasional transactions. This clause overcomes the Supreme Court's view in H.A. Ansari's case which required that there should be some regularity in dealings for the transaction to be a business and

11. *Burmah Shell Oil Storage and Distributing Co. of India ltd. [1973] 31 STC 426 (SC)*

12. *State of Tamil Nadu and Another vs. Board of Trustees of the Port of Madras 1999 4 SCC 630 (SC)*

13. *Commissioner of Sales Tax vs. Sai Publication Fund AIR 2002 SC 1582 (SC)*

also overcomes a contention of the assessee that they are not 'carrying on' (a degree of continuity) a business activity

6.15. For the current discussioxn, clauses (d) onwards can be ignored being not relevant. It is more than evident that clauses (b) and (c) also link themselves to clause (a) and therefore, the bedrock of taxability will need to be examined primarily from clause (a). Clause (a) is reproduced once again for ready reference:

Any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit

6.16. A plain reading of the above provision represents a conflict in the same. Each of the specific words trade, commerce, manufacture, profession, vocation, adventure, wager have the intention of pecuniary benefit essentially built into those activities. One is not sure whether the last phrase 'whether or not it is for a pecuniary benefit' can dilute each of the preceding words to an extent that the words loose their essence or meaning. To continue the example of the religious trust selling jewellery, can it be said that the trust is undertaking a trade just because the last phrase apparently dilutes the requirement of pecuniary benefit.

6.17. Each word in the Statute has to be given full effect. Just like one cannot ignore the phrase 'whether or not it is for a pecuniary benefit', one cannot ignore the essence of profit motive being an important indicator of each of the preceding words. This conflict therefore has to be resolved in a manner to make the Statute workable as a whole. It is therefore felt that the preposition 'for' used in the above phrase should be interpreted as an 'end-result' of the activity rather than as the 'intention' of the activity. To cite an example, if an e-commerce company sells goods at cost and does not actually earn any pecuniary benefit from the transaction, it would still be considered to be in trade and the non existence of actual pecuniary benefit from the transaction cannot be used as an argument to treat the transaction as not in the scope of supply.

6.18. The above interpretation is also justified on the ground that the word 'intended' is not specifically used in the above phrase. There are many other provisions in the law where the word 'intended' if the Legislature wishes to determine a consequence based on the intention. One may refer to the definition of inputs, input services, etc. in this regard. In the absence of similar wording both in the definition of business as well as in the scope of supply, we will need to interpret the phrase as a fact i.e. the end result and therefore the dilution also for the end result rather than the intention.

6.19. In the background of the above discussion, it may be important to examine some scenarios to determine the scope of taxability for charitable trusts:

Scenario	*Example*	*Whether covered under GST?*
Primary Objective is not business. Certain incidental activities carried out which may partake the character of business. However, such activities dependent on the primary objective	A religious trust selling prasadam, religious books, etc.	No[14]
Primary activity carried out with commercial objectives in mind and the profit applied towards charitable causes	Hospital run by a trust	Yes
Primary Objective is not business. Independent activities carried out which may partake the character of business.	Mandap Keeper and Catering Services rendered by a trust.	Yes

7. Specific Exemptions

7.1. The GST Law being an amalgam of both Value Added Tax as well as the Service Tax legislations, has found provisions from both the legacy laws. In the context of charitable trusts, it follows the philosophy of VAT by restricting the applicability of the law itself to such supplies which are in the course or furtherance of business whereas it also follows the philosophy of service tax to provide identified exemptions from the purview of taxability. It is a trite law that before interpreting the exemption entry, it is important to demonstrate the taxability and in that sense, it is important to establish that the supply is in the course or furtherance of business before looking at the specificity of the exemption. However, most of the clarifications and advance rulings merely look at the exemption entries and accordingly decide on taxability adding to the confusion.

7.2. For example, the CBIC in its Flyer 39 dated 1-1-2018 clarifies that Notification No. 12/2017-Central Tax (Rate), dated 28th June, 2017 exempts services provided by entity registered under Section 12AA of the Income-tax Act, 1961 by way of charitable activities from whole of GST. Since the term charitable activities is defined, the exemption becomes very specific. While the income from only those activities listed in the said definition is exempt from GST, income from the activities other than those mentioned above is taxable. Thus, there could be many services provided by charitable and religious trust which are not considered as charitable activities and hence, such services come under the GST net. This clarification totally ignores the scope of supply provided under Section 7(1)(a) and therefore, with due respect, could be considered as misleading.

7.3. Many specific exemptions have been provided and clarified. However, in view of space constraints, I would like to end this article. Readers may well refer to the Flyer and the Notification referred to above and examine the scope of exemption entries – the only caveat is that such an exercise should be only undertaken after satisfying that the activity is covered under the scope of supply laid down under Section 7(1)(a) of the CGST Act, 2017.

14. It may be noted that there are adverse advance rulings wherein the Authority has determined that the term 'business' does not require a profit motive and that such supplies are taxable in view of the very extensive definition of business. Hence the issue will need to be litigated.

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Mergers, Amalgamations & Closure/De-Registration of Charitable Institutions

CA Gautam Shah

Mergers and Amalgamations under The Maharashtra Public Trusts Act, 1950

For some Charity is a way of life. Charitable Institution or Charitable organisation or Non Government Organisation is all into charitable activities which are for the benefit of people at large without any distinction about caste, creed, colour, language, region or religion.

The three most important formations to undertake charitable activities are,

Charitable Trust

Societies

Section 8 Companies

All the above three are governed by their own respective statutes.

Charitable Trust created in Maharashtra is governed by The Maharashtra Public Trusts Act, 1950 and The Bombay Public Rules of 1951.

Societies are governed under the Societies Registration Act, 1860.

Section 8 Companies under the Companies Act, 2013.

From above it can be seen that each creation has its own Act and rules and therefore each will have different procedures.

Now, coming to mergers and or amalgamations, the most important is for the Charitable Trust and Societies. Let us first ask a simple question,

Whether a Charitable Trust can be amalgamated into another Charitable Trust?

Let us take an example in Maharashtra, as Maharashtra is one of the states which has very good Charitable Trust Law. A Charitable Trust created in Maharashtra and registered under the Maharashtra Public Trusts Act, 1950 would like to amalgamate with another Charitable Trust which is also situated in Maharashtra and registered under the Maharashtra Public Trusts Act, 1950. There is a possibility of amalgamation, provided all the provisions of section 50A(2) The Maharashtra Public Trusts Act, 1950 is satisfied. Let us first look into section 50A(2) of The Maharashtra Public Trusts Act, 1950.

Section 50A: Power of Assistant or Deputy Charity Commissioner to frame, amalgamate or modify schemes,

Sub-section (2) states as under,

Where the Assistant or Deputy Charity Commissioner is of opinion that in the interest of the proper management or administration, two or more public trusts may be amalgamated by framing a common scheme for the same, he may, after

(a) Publishing a notice in the Official Gazette and also if necessary in any newspaper which in the opinion of the Assistant or Deputy Charity Commissioner is best calculated to bring to the notice of persons likely to be interested in the trust with a wide circulation in the region in which the trust is registered, and

(b) Giving the trustees of such trust and all other interested persons due opportunity to be heard, frame a common scheme for the same.

The provisions of this section came into force, in the State of Maharashtra, from 1st January, 1961 and in the State of Gujarat, from 1st July, 1961. In order to improve the working of public trusts the Charity Commissioner has been empowered by the Legislature to frame a scheme. The application shall set out concisely the particulars as provided in Rule 26. The power is given to the Assistant or Deputy Charity Commissioner to frame a scheme, without a suit being filed u/s. 50 of the Maharashtra Public Trusts Act, 1950. The Assistant or Deputy Charity Commissioner is also given the power to amalgamate two or more public trusts, if it is in the interest of the trusts by framing a common scheme.

Amalgamation involves a process by which two things are being united. In order to improve the working of public trust, particularly, small public trusts which have been running in deficit or which have large expenditure on administration, steps should be taken for amalgamation of these trusts, to secure better management at reduced cost. There is no duty cast on the Charity Commissioner to prevent deficits; but as public trusts are perpetual institutions, the Charity Commissioner may, however, persuade the trustees of small public trust, which have been running into deficit, to agree to their amalgamation with other trusts with like purposes.

The powers of amalgamation are necessary in many cases so that both the trusts which are amalgamated should run smoothly. The provision of public notice is necessary inasmuch as the trustees and other interested persons must have their say before the amalgamation is ordered. Opportunity much be given to the trustees to show cause which must be reasonable, effective and real. (***Taher Alimohamad Poonawala vs. Quisar Shaikh Nomanbhoy, 1995(1) Mah. L.J.906: AIR 1995 Bom. 422***).

Mergers of religious Public Trusts do not take effect by mere passing of resolution or by "change report". Merger of a Public Trust cannot be effected except in accordance with provisions of Public Trusts Act and without prior permission of Charity Commissioner. The procedure as laid down for amalgamation as to be followed. The Charity Commissioner has to record a satisfaction after hearing the trustees, both of amalgamating trust and amalgamated trust, that it is necessary or expedient in the interest of proper management or administration of a public trust to frame a scheme (***Dr. Chhotubhai L. Patel vs. State of Gujarat & others***).

As per Rule 26 of the Bombay Public Trust Rules, 1961 (Gujarat), as to follow the following procedure,

(1) Every application under section 50A to the Charity Commissioner shall set concisely the material facts about the Public Trust and shall contain *inter alia* the following particulars, that is to say:

(a) Names, occupations and addresses of the applicants;

(b) Name and description of the trust and its office address;

(c) Registered number of the trust according to the Register of Public Trusts;

(d) Approximate value of the trust properties;

(e) Names and addresses of the trustees and managers;

(f) Approximate annual income of the trust;

(g) Objects of the trust;

(h) Nature of applicant's interest in the trust;

(i) Reasons for amalgamation;

(j) List of documents relied upon;

(k) Particulars of application, if any, u/s. 92 of the Code of Civil Procedure, 1908 or u/s. 51 of the Bombay Public Trusts Act, 1950 in regard to the trust made earlier by the applicants or to their knowledge by other persons and the results thereof.

(2) The application shall, as far as possible, be accompanied by copies of all the relevant documents including the instrument of trust, if any.

(3) The application shall be accompanied by a draft scheme.

Before embarking upon the amalgamation of Public Charitable Trust the following need to be verified,

1. Whether the trust deed or the constitution of the public charitable trust have given power to the trustees and or managing committee for amalgamation and thereby framing a scheme.

2. Whether audited accounts are filed in the office of Charity Commissioner, if so, last three year audited accounts with the Proof of acknowledgement much be verified.

3. Whether the trustees who proposed to enter into the amalgamation process are on the record of the Charity Commissioner (Their names are recorded in Schedule 1 or there is a speaking order from the Office of Charity Commissioner).

4. Whether the amalgamation is in the interest of public trust and for proper management or administration of public trust.

5. Reason for amalgamation must be in the interest of people at large.

After filing the amalgamation application u/s. 50A(2) of the Maharashtra Public Trusts Act, 1950, the Charity Commissioner will instruct the amalgamated trust and the amalgamating trust to publish amalgamation notice in the newspaper in the language of the region with a wide circulation in the region in which the trust is registered. Further the amalgamation between the amalgamated trust and amalgamating trust notice need to be publish in the *Official Gazette*. In certain situation the Public notice in the newspaper is not viable as the trustees are not in a position to bear heavy cost of publishing notice in two newspapers about framing of a scheme amalgamating two or more trusts and in such situation the publication of notice in the newspapers are left at the discretion of the Charity Commissioner.

The trustees of amalgamated trust and the amalgamating trust are given enough hearing opportunity to show cause which must be reasonable, effective and real. In short, the Charity Commissioner office calls for the trustees to have detailed enquiry about the amalgamation.

The societies which are registered under The Societies Registration 1860 will have to follow the

amalgamation laws under The Maharashtra Public Trusts Act, 1950 if the societies are registered in Maharashtra.

Controversial issues

Whether Charitable Trust can be amalgamated in the societies which are created in Maharashtra?

Prima facie there is no problem if charitable trust is amalgamated into societies, if societies are registered in Maharashtra. As per section 2(13) of the Maharashtra Public Trusts Act, 1950 Public trust is defined as under,

"PUBLIC TRUST' means an express or constructive trust for either a public religious or charitable purpose or both and includes a temple, a math, a waqf, (church, synagogue, agiary or other place of public religious workship) (a dharmada) or any other religious or charitable endowment and a society formed either for a religious or charitable purpose or for both and registered under the Societies Registration Act, 1860. So the definition of Public Trust includes Societies created under the Societies Registration Act, 1860.

Further section 2(7A) of the Maharashtra Public Trusts Act, 1950 defines "Instrument of Trust" as under,

Instrument of trust means the instrument by which the trust is created by the author of the trust and includes any scheme framed by a competent authority or any Memorandum of Association and rules and regulations of a society registered under the Societies Registration Act, 1860, in its application to the State of Maharashtra.

From above we can presume that society can be amalgamated into trust and *vice versa* and procedure will be almost be same as that of Trust amalgamation with another Trust.

But before embarking upon amalgamation of Charitable Trust into Society or *vice versa*, it is to be kept in mind that both are governed under different statutes, hence if absolutely necessary in the interest of public at large and the Charitable institution, the Charity Commissioner may approve the amalgamation.

Whether Charitable Trust can be amalgamated with Section 8 Company?

Prima facie why not? Both are Non Profit Organisation. The basis for creation both are for charitable activities which will benefit people at large. Both are registered, both can avail 12AA registration under the Income Tax Act, 1961 and both can be 80G compliant. So all this leads to that it is possible to amalgamate Charitable Trust with Section 8 company. The only problem is the applicable of statutory laws, Charitable Trust in Maharashtra is governed by The Maharashtra Public Trusts Act, 1950 and Section 8 Company is governed by The Companies Act, 2013. So, Charitable Trust to be amalgamated with Section 8 Company is a very big challenged. Most of the recent Trust deeds clearly mentions the amalgamation clause which is as under,

Amalgamation Clause

The trustees may amalgamate this trust and its properties with any trust or institutions wholly or any of them, similar to this trust provided they pass an unanimous resolution to that effect and sanction (if necessary) of the appropriate authority as may be required.

In the amalgamation clause it is clearly mentioned that the trust can be amalgamated with another trust or INSTITUTIONS, which gives an understanding that Trust can be amalgamated with Society or Section 8 company. On deeper understanding about the Maharashtra Public Trusts Act, 1950 and The Bombay Public Trust Rules, 1951, it can be presumed and concluded

that Charitable Trust cannot be amalgamated with Section 8 company, as the governing statutes are different. Charitable Trust is governed by the State law and Section 8 companies by National law.

Hence the above can be summarised as under,

Charitable Trust can be amalgamated with another Charitable Trust, provided object clause is more or less same.

Charitable Trust can be amalgamated with Charitable Societies, provided object clause is same and they are registered under the Maharashtra Public Trusts Act, 1950 and The Gujarat Public Trusts Act, 1950. It is difficult but not impossible.

Charitable Trust cannot be amalgamated with Section 8 companies as the governing body is different.

Charitable Societies cannot be amalgamated with Section 8 companies as the governing body is different.

Closure/De-Registration of Charitable Trust under The Maharashtra Public Trusts Act, 1950.

Section 22(3A) of the Maharashtra Public Trusts Act, 1950 as per Maharashtra Amendment Act. No. IX of 2016 section 2 (w.e.f. 23rd February, 2016) states as under:

"The Deputy or Assistant Charity Commissioner may, after such detailed and impartial inquiry and following such procedure as may be prescribed, de-register the trust on the following grounds :

(a) When its purpose is completely fulfilled; or

(b) When its purpose becomes unlawful; or

(c) When the fulfilment of its purpose becomes impossible by destruction of the trust property or otherwise; or

(d) When the trust, being revocable, is expressly revoked; or

(e) When the trustees are found not doing any act for fulfilling object of the trust:

Provided that, no trust shall be de-registered under the clause (e) unless its trustees have committed default in reporting the changes under sub-section (1), in submission of the audited accounts as prescribed by sub-section (2) of section 33 or sub-sections (1A) of section 34 or in making any other compliance prescribed or under this Act for a period of five years from the last date of reporting the change, submission of the accounts or making the compliance, as prescribed by or under this Act or the rules made there under, as the case may be.

Before the amendment as inserted by Maharashtra Amendment Act No. IX of 2016, the charitable trust was never allowed to be de-registered or closed. Trust created under the erstwhile The Bombay Public Trusts Act, 1950, before the above amendment was always Irrevocable and still Irrevocable, except in situation as stated u/s. 22(3A) of the Maharashtra Public Trusts Act, 1950. There is a saying "ONCE A TRUST, ALWAY A TRUST". A Charitable Trust cannot be closed under any circumstances. This amendment is brought in the year 2016, as out of some 8.5 lakh Charitable Trusts registered along in Maharashtra, almost 70% of the Trust were defunct or not having charitable activities. The compliance cost has increased so much that it is not viable to keep alive Charitable Trust wherein there is no income. Further there is no one willing to continue to work as Trustees as there are personal liabilities attached with the working. Further the laws are drafted in such a way that it is difficult to compensate the Trustees and or Managing Committee who are willing to work full time for the noble cause.

Also this winding up or closure or de-registered is a recent thinking of the Government and it became a matter of debate. As seen that most of the Trust created as per the Maharashtra Public Trusts Act, 1950, there is a clause which states, that the Trust is irrevocable, which means perpetual. Recently that is 4 years back due to some interpretation of CAG report before granting 12AA registration certificate; the learned Commissioner of Income Tax (Exemptions) started insisting on having a dissolution clause or winding up clause. This requires a hell of hard work and money, as the Trust deed needs to be amended and filed in the Office of Charity Commissioner for framing scheme u/s. 50A(1) under the Maharashtra Public Trusts Act, 1950, which may take 4 months to 2 years to approve this scheme (only inserting Dissolution or winding up clause) and by that time whatever income is received by the to Charitable Trust is taxed as a maximum marginal rate. No doubt most of the courts have struck down these wrong interpretations of law, but in the process few genuine Charitable Trusts suffered and had to pay the price, by paying Income Tax wrongly for the wrong thinking. Any law which has been introduced should strictly be prospective and not retrospective and especially not for Charitable Trust which are doing such a noble work.

Challenges to be faced by the Charitable Institution who wishes to close or de-register the Trust under the Income-tax Act, 1961

A society, company, trust or an institution carrying on charitable objects may voluntarily wind up its activities and dissolve or may also merge with any other charitable or non-charitable institution, or it may convert into a non-charitable organization.

The Charitable Trust which is registered under the Maharashtra Public Trusts Act, 1950 can be de-registered or wound up, provided there is clause in the Trust deed. The challenge is that all the Trust deeds created before decades did not have winding up or dissolution clause, as there was and is a firm belief that Charitable Trust is irrevocable. If a Trust is Irrevocable then why there should be dissolution or winding up clause. The erstwhile Bombay Public Trusts Act, 1950 and the new Maharashtra Public Trusts Act, 1950 has provision which states that if the Trust Property in an event of closure, all its properties will be transferred to Trust having similar charitable object clause, with a specific mention that no Trustees, their legal heirs, their relatives will enrich out of this closure. The basic idea of creating a Charitable Trust is to do Charitable activities for the welfare of the people at large without any discrimination of caste, creed, language, color, region and or religion. It is absurd to have a clause which states that the Trust is irrevocable and winding up clause. But the intention of the Government may be if the clause is there, the Trustees will not misused the Trust properties for their own benefit or for the benefit of their legal heirs and or The Society which is registered under the Societies Registration Act, 1860 and subsequently registered under the Maharashtra Public Trusts, 1950, will be predominantly governed by the Societies Registration Act, 1860. If 3/4th members are of the opinion that the Society should wound up, then after passing the necessary resolution and stating the reason, the Society will be wind up. The Procedure will be same as applicable to Charitable Trusts which are registered under the Maharashtra Public Trusts Act, 1950.

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Foreign Contribution Regulation Act - Its evolution, issues and pitfalls

CA Shariq Contractor

The preamble to the Foreign Contribution (Regulation) Act, 2010 (FCRA) states that the Act is to regulate and in certain situations prohibit the acceptance and utilisation of foreign contribution or foreign hospitality for any activities detrimental to the **National Interest** and for matters connected therewith or incidental thereto. In view of this very clear objective, it is significant to note that FCRA is governed by the Home Ministry and not the Finance Ministry.

The predecessor to this FCRA was the earlier Act of 1976, which was passed during the emergency for the ostensible reason to curb foreign interference in domestic politics. It was an era where the ubiquitous "foreign hand" dominated the political discourse. One would have expected that with liberalisation, when foreign funding and investments was liberally allowed to enter India and when the suspicion of the "foreign hand" was receding, India would have done away with this Act or at least substantially diluted its rigours. Unfortunately, the new avatar of FCRA is much more stringent.

Protecting "National interest" is indeed a very lofty ideal, but as they say, the road to hell is paved with good intentions. The Act gives unfretted power to the Government to control civil society organisations, particularly the ones engaged in areas inconvenient to those in position of power. This has raised serious concerns whether in the name of "national interest" FCRA has crossed the red line of legitimate restrictions that the Government must impose to foreign funds flowing into the country. However, leaving that for a separate discussion, let us focus on analysing the provisions of this Act, which is relatively unknown and as a result often practiced in breach.

So let us begin by understanding the two terms (foreign contribution and foreign source) used in FCRA, which are central and are the very core of the Act.

Foreign Contribution (FC) – Section 2(1)(h)

Foreign contribution is defined to essentially mean any donation, delivery or transfer made by a foreign source of any article, currency (whether Indian of foreign) or any security. The definition is very wide and even advance or loan received from foreign source is treated as FC. It also covers any indirect receipts from a foreign source. Even if money or article is rooted through several intermediaries, it will not be cleansed of being treated as foreign source if the original source is foreign.

Rule 6A provides that any articles given as gift for personal use would not be treated as FC, if the market value of such article is not more than ₹ 1 lakh.

Any amount received by any person, from a foreign source by way of fee (including fees

charged by an educational institution in India from foreign students) or towards cost in lieu of goods sold or services rendered in the ordinary course of business, trade or commerce whether within or outside India shall not be treated as FC.

The bare reading of the explanation to the section seems to suggest that only cost in lieu of goods sold and services rendered is excluded from the definition of foreign contribution. What if the goods are sold or services rendered after adding a profit margin? In any case, how would one determine the exact cost; would it include overheads or not? Even if the NPO has no intention of making profits, it might realise some surplus as it would price its product or service based on certain costing assumptions. It would be impossible to arrange affairs in such a manner that the amount realised exactly matches the cost. Clearly, restricting the explanation only to cost will be practically unworkable and self-defeating. Hence, it must necessarily be interpreted liberally to mean that if a fair price is paid for such goods or services then the same would not be treated as foreign contribution. However, if the amount is paid to purchase say a ticket to a charity event, which is priced well above the normal ticket price by appealing to the altruistic sentiments of the attendee, then the payment would be treated as donation (as donation is embedded in the ticket price) and not for services rendered. In this case the ticket price paid would be treated as FC.

Another interesting example is that of a temple trust offering the facility of online Aarti at a charge. If the payment is from a person who is not a citizen of India then it would be treated as FC and would not qualify for exemption as the payment cannot strictly be treated as fees nor can it be treated as services in the ordinary course of trade, commerce or business.

Foreign Source – Section 2(1)(j)

Any donation, delivery or transfer made by any **foreign source** is treated as **foreign contribution.** Hence, the definition of foreign contribution and foreign source are intertwined. The definition of foreign source is an inclusive definition, again with a very wide coverage. It covers a foreign government or its agency, any international agency (other than certain specified agencies such as United Nations, World Bank etc.), foreign company, multi-national corporation, any other foreign entity such as trade unions, trusts, societies, clubs, formed or registered outside India andforeign citizens. It also covers a company where more than 50% of the share capital is held by a foreign government, entity or citizen.

Receipts from foreign citizens are considered as foreign source while receipts from Indian citizen are not treated as foreign source, even if it is from an NRI in foreign currency. The basic principle is to determine the source from which the currency or asset is being received. If the source is Indian, then it does not matter whether the currency is Indian or not. Conversely, if the source is foreign, then even if the receipt is in Indian rupees, the same would be considered as FC. Contribution received from an Indian origin person holding a PIO/OCI card would also be considered foreign source as such person would be holding foreign citizenship.

A Corporation incorporated in a foreign country would be deemed to be a multinational corporation if it has a subsidiary or a branch or a place of business intwo or more countries or it carries on business or operations in two or more countries. Therefore, a foreign company having operations in any one or more country besides India would fit into this definition. For example, several foreign banks operating in India would fall foul under this category and hence amounts received from them would be categorised as FC.

One of the most controversial provision was that amounts received from even Indian companies would be treated as foreign source, if foreign shareholding of such company was more than 50%. Post liberalisation, there are several Indian companies where the foreign holding is more than 51%. Hindustan Unilever, HDFC, ICICI bank,

would fall under this category. Several NPO's and even political parties were routinely accepting contributions/donations from such companies in clear violation of FCRA. Both the BJP and Congress were pulled up by the Delhi High Court in 2014 for violating the law by accepting contribution from the Indian subsidiaries of the London based multinational, Vedanta.As a response, the Government introduced an amendment to section 2(1)(j) of the FCRA, so that a company so far categorised as a foreign source now ceases to be so. A proviso was added to the above section to state that if the foreign shareholding is within the limits specified for foreign investment under the FEMA regulations, then such company will not be treated asforeign source. Interestingly, to wash away all past sins, this amendment was introduced with retrospective effect from 5th August 1976, being the date when the earlier FCRA 1976 was legislated.

The provisions of FCRA can be broadly classified in the following three categories:

1. Blanket prohibition (barring certain specific exceptions) on certain persons from accepting FC.
2. Restriction on certain persons from accepting foreign hospitality.
3. Regulating the acceptance of FC by persons having a definite cultural, economic, educational, religious or social programme.

Blanket Prohibition

Section 3 of FCRA lists persons who cannot accept FC. These include:

1. Candidates for election;
2. Judges and Government servants;
3. Members of any legislature;
4. Political party and office bearer thereof. It also includes any organization of a political nature as may be specified by the Central Government;
5. Association or company engaged in the production or broadcast of audio news oraudio visual news or current affairs programmes through any electronic mode or any other mode of mass communication;
6. Correspondent, columnist, cartoonist, editor, owner, printer or publisher of aregistered newspaper or company referred to in point (5); and
7. Individuals or associations who have been prohibited from receiving FC.

FCRA empowers (refer section 5 & rule 3) the Government to frame guidelines for terming an organisation as being of a political nature. These guidelines have givens weeping powers to the Government to prohibit organisations,whose activities or ideology or programmes are, in the view of the Government, "political in nature"from accessing FC. It is perhaps revealing to note that the FCRA rules state that the Government may specify Trade Unions, Students Unions, Workers' Union, Youth Forums as organisations of political nature if their objectives have any political element. It is specifically stated that organisations which habitually engages itself in or employs common methods of political action like "bandh" or "hartal", "rasta roko", or "jail bharo" in support of public causes could be ground for specifying the entity as an organisations of political nature.

It seems that the ghost of the "foreign hand" clearly continues to haunt the Indian polity and its law makers.

Any association or company engaged in the production or broadcast of news or current affairs programmes is also banned from accepting FC. So we have an interesting situation where under FCRA no FC is permitted under these activities and yet companies engaged in up-linking of 'News & Current Affairs' on TV channels and through digital media, are allowed FDI within

permissible limits (49% and 26% respectively) with Government approval. Fortunately, the amounts received in the ordinary course of business are specifically excluded, so commercial entities in general would be outside the ambit of FCRA. However, an organisation carrying on any definite cultural, economic, educational, religious or social program is barred from receiving FC for the above activities.

Section 4 provides that FC can be accepted even by the prohibited category in the following specific situations.

1. By way of remuneration or in the ordinary course of business or in the course of international trade or commerce;
2. As an agent of a foreign source in relation to any transaction made by such foreign source with the Government;
3. By way of gift or presentation as a member of an Indian delegation. However, the gift/present should be accepted in conformity with the Government rules in this regard;
4. Gift from a relative. However, if the gift is in excess of ₹ 1 lakh, then then the Central Government will have to be informed about such gift; and
5. Any scholarship, stipend or any payment of like nature.

Barring the above exceptions, there is blanket prohibition on acceptance of FC by the above mentioned persons. The provisions are very stringent and reminiscent of the old FERA days where foreign exchange violation was considered as destroying the economic fibre of the society and hence was to be dealt with ruthlessly.

Restriction on accepting Foreign Hospitality

Section 6 of FCRA prohibits members of the legislature, office bearers of a political party, judges and Government servants from accepting any foreign hospitality while visiting another country, except with prior permission of the Government. In case of medical emergency outside India, the requirement of prior permission is waived. However, even in such cases, the person receiving the medical help is required to intimate the Government within one month about the source from which and the manner in which the hospitality was received by him.

Foreign hospitality has been defined under section 2(1)(i) to mean any offer, not being a purely casual one, made in cash or kind by a foreign source for providing a person with the cost of travel to any foreign country or territory or with free boarding, lodging, transport or medical treatment.

Interestingly, what constitutes a "purely casual offer" is not clear. For example, would paying for hotel accommodation be prohibited, but inviting and consequently paying for a single dinner be permitted on the ground that is "purely casual"?

Regulating the acceptance of foreign contribution by persons having a definite cultural, economic, educational, religious or social programme (CEERS)

Any individual or organisation carrying on a CEERS is prohibited from accepting FC unless such person has obtained a certificate of registration or has obtained prior permission for accepting such contribution from the Central Government (refer section 11 & 12 and Rule 9).

The common perception is that only NPOs are affected by these provisions. Though this is largely true, it needs to be noted that even a private limited company, LLP, partnership firm, HUF and individuals would all have to comply with the registration/prior permission requirement if they are engaged in CEERS. Of course, if such entities are engaged only in business/commercial activities then they would not fall within the ambit of the FCRA.

As specified in section 7, NPO eligible to receive FC cannot in turn transfer the same to any intermediary unless such intermediate person/

entity is also registered or has obtained prior permission.

The process of registration is stringent and fraught with bureaucratic processes. The Act as well as the Rules lay down detailed requirements to be fulfilled for grant of certificate of registration. FCRA specifically provides that the person making an application for registration should demonstrate that it has a track record in its field of activity and for which the FC is proposed to be utilised. Though the Act does not specify the number of years for which such NPO should be in existence, as a matter of practice, and as mentioned in the FAQs published by the government, such NPO is expected to be in existence for at least 3 years.

If the NPO is not able to fulfil the requisite conditions for registration, then the only alternative would be to apply for prior permission, for which the requirements laid down in the rules are relatively less stringent. However, even for prior permission, the NPO would have to show that it has a reasonable project for which the FC is proposed to be utilised. Prior permission granted would be valid only for the specific purpose and source for which it is obtained. The permission is typically granted for a specified amount, which can be received in tranches and no upper limit has been set for the same.

The authorities have wide powers under section 12(4) to deny registration or prior permission on the ground that the person or organisation is working to the detriment of national interest. For example, (the list being only illustrative) the NPO should not be engaged in:

1. Religious conversion through inducement of force;
2. Creating communal tension or disharmony;
3. Propagation of sedation or advocating violent methods to achieve its ends; or.
4. Activity to divert funds for undesirable purposes.

Further, registration or prior permission can be denied if the acceptance of FC is likely to affect prejudicially the sovereignty and integrity of India or is against the security, strategic, scientific or economic interests of the State or is opposed to public interest.

Renewal of Registration – Section 16 & Rule 12

Under the old FCRA, registration once granted was permanent. The current FCRA requires online renewal of registration every 5 years. Renewal application is required to be filed six months before the earlier FCRA registration expires. A delayed application for renewal of registration may be accepted only if sufficient grounds for such delay is explained in writing. However, in no case can such an application be filed beyond a period of four months from the date of expiry of the earlier registration. The Government also has wide powers to suspend and under specific situations to cancel the certificate of registration.

Project Account – Section 17

FC can be received only in a single designated bank account and it is not permissible to open multiple bank accounts. All FC must necessarily and strictly be received first in this designated bank account. Any interest or income arising from FC should also be deposited into this bank account. Similarly, any income from sale of FCRA assets, investments or contribution in kind should be deposited in this account.

Often NPOs have projects in far-flung and remote places and in such cases it may be necessary to open a bank account at the project site. Recognising this need, it is provided that more than one bank account; called “utilisation account” can be opened for operational convenience. Such “utilisation account” would typically receive FC by way of transfer from the main designated account, where all FC would be first received. It should be strictly ensured that local funds are not deposited in such “utilisation account” and the account is used strictly as

a disbursement account for meeting on site expenses. Though there is no specific restriction on transfer of funds from one utilisation account to another, such practice is frowned upon and hence should be avoided.

Mixing of funds

At no point should foreign funds and local funds be mixed. This is considered as a serious offence and may also lead to cancellation of FCRA registration along with other monetary and non-monetary implications; including imprisonment up to 1 year.

Separate accounts. Section 19 & Rules 11 & 17

It is mandatory to maintain separate set of accounts and records, exclusively for the FC received and utilised. Separate salary register, fixed assets register, investment register, etc., are also required to be maintained for FC funds. The Income & Expenditure account, Balance Sheet and Receipt & Payment account relating to FC is required to be filed with the authorities electronically.

Often foreign funding agency demand that separate bank account be opened specifically to manage and monitor the FC sent to India by them. Unfortunately, that is not permitted and needs to be clearly explained to the funding agencies. NPOs can however, maintain separate ledger and sub-ledger accounts for each donor or for each project so that it can track the amount received and utilised in each individual case. This would also be useful in preparing and submitting the required financials with the FC authorities.

Foreigners on Board or committees

An organisation entitled to receive FC is generally not entitled to appoint a foreign national (other than of Indian origin), as a member of the executive committee or governing board. Further, under no circumstance can a foreign national be the Chief Functionary of such organisation. However, it has been clarified in the FAQs issued by the Government that foreigners may be associated with the organisations receiving FC in a purely honorary capacity depending on the persons stature in his/her field of activity. The rationale again seems the overhanging worry of a foreign hand controlling the affairs and functioning of an Indian entity receiving FCs.

However, in certain situations and on a case to case basis, a foreigner may be permitted to join the governing board by taking permission from an authority higher than the competent authority.

Administrative expenses – Section 8 & Rule 5

In recent times, concerns have been raised that NPOs do not have adequate transparency in their administration and that disproportionately high amount is spent on administrative expenses rather than on the core charitable objects. FCRA regulations provide that administrative expenses of an NPO from FC funds should not exceed 50% of the total FC received during the year and expenses in excess of 50% can be defrayed only with the prior approval of the Central Government.

The rules define what constitutes administrative expenses and it includes salaries of members of the executive committee or governing council, salaries of management personnel, office expenses such as electricity, water charges, telephone charges, repairs to premises, stationery and printing charges, accounting expenses, legal and professional charges, rent of premises and so on. It is a detailed list but has its fair share of ambiguity. For example, it is not clear whether salary of programme staff or field workers would constitute administrative expenses. The wordings of the rule would suggest that only salary of management personnel should be treated as administrative expenses. However the FCRA department seems to be of the view that all staff salary, whether program or administrative should be treated as administrative expenses.

Further, FCRA caps administrative expenses at 50% of the FC received. This means administrative expenses are compared with FC

received and not with FC utilised during the year. This creates unnecessary distortion if, for example, FC received is high in one year while utilisation is higher in the next year. In the first year the cap for administrative expenses will be higher as that is the year in which FC was received. However, in the second year where the major chunk of expenses is incurred, the administrative expenses will be necessarily higher, but the cap would be lower as it is linked with FC received and not with its utilisation. The correct approach would be to treat the total FC utilisation as the base and compare the same with FC related administrative expenses for that particular financial year. Fortunately, in practice that is exactly what the FCRA department is doing.

Investment in mutual funds – Section 8 & Rule 4

FCRA prohibits investment in speculative activities and FC funds are strictly to be utilised only for the definite purpose for which they were received. They cannot be invested where there is an element of risk or high volatility by way of appreciation or depreciation of the original investment, linked to market forces. Accordingly, investment in mutual funds or in shares have been specifically classified as speculative activity. This would imply that even investment in mutual fund schemes that only invest in Government bonds is not permitted.

Fines and Punishment. Sections 33 to 41

The offences under this Act are subject to penalty and imprisonment. Some offences for which penalty is prescribed are as under:

Offence	Fines and Punishment
Seeks prior permission or registration by means of fraud, false representation or concealment of material facts	Imprisonment up to 6 months and/ or fine
Accepting or assisting in accepting FC in contravention of the FCRA Act or Rules	Imprisonment up to 5 years and/ or fine
Offences for which no separate penalty has been provided in the Act	Imprisonment up to 1 year and/or fine

Any person convicted of an offence relating to acceptance or utilisation of FC a second time, is debarred from accepting FC for a period of 5 years from the date of the 2nd conviction.

The Ministry of Home Affairs has issued a notification dated 5th June 2018, specifying the offences that can be compounded (before prosecution is launched) and the compounding penalty payable in each such case.

In Conclusion

FCRA 2010 is by and large old wine in new bottle. Unfortunately, in a lot of respects the provisions have been made far more stringent than what they were under FCRA 1976. Indeed, funding received by NPOs need to be monitored and regulated. Unscrupulous NPOs exist and they may serve as conduits for money-laundering and for other anti-national activities. However, the question is whether FCRA is the right answer or is there a better way to address these legitimate concerns.

A seven-member task force was set up way back in 2009 to create a national level self-regulatory agency that would monitor and accredit Civil Society Organisations. It was to be an independent, statutory body along the lines of the Bar Council. The Task Force submitted its report to the Planning Commission in September 2010. But those recommendations never saw the light of the day. Perhaps, it is time to repeal the FCRA and revive the idea of an autonomous, self-regulatory agency as recommended by the task force.

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Drafting of Trust Deed, Recent amendments & Important compliances under MPT Act & Registration with Niti Aayog

CA Suhas K. Malankar

Brief background

In the state of Maharashtra legislation governing Public Trusts is The Maharashtra Public Trusts Act (the MPT Act). The title of the Act changed in 2012 from 'The Bombay Public Trusts Act, 1950 (BPT Act) to 'The Maharashtra Public Trusts Act' with retrospective effect from 1st May 1960 by the Maharashtra (Change of short titles of certain Bombay Acts) Act 2011. Relevant Rules are 'The Maharashtra Public Trust Rules' (title changed in May 2019). BPT Act was enacted to regulate and to make better provisions for the administration of public religious and charitable trusts in the state of Bombay. The Act is applicable to all the public religious and charitable trusts where office of administration and or substantial portion of its properties are situated in the state of Maharashtra. Its provisions are applicable to Societies registered under The Societies Registration Act, 1860 where their administrative office or substantial portion of properties of such society is situated in the state of Maharashtra. (SC has held that where main trust in one state and other few branches are spread in another state situs of principal math will determine applicability of the Act - ***Charity Commissioner of Bombay vs. Administrator of Shringeri Math AIR 1969 SC 566: 71 BOM.L.R. 678 SC).*** Certain organizations/person/ associations collecting money for charitable or religious objects are also governed by certain provisions of the MPT Act. However provisions of the MPT Act do not apply to Sec. 25/Sec. 8 companies and to private trusts.

Before we take up subject of drafting of trust deed for public trusts it is essential to study and understand certain related basic terms/concepts as given below:

Meaning of the term "Trust"

Term trust is not defined in the MPT Act, therefore one has to go to the definition of Trust as given in sec. 3 of the Indian Trusts Act, 1882 which is as follows:-

A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner:

Section further states….*the person who reposes or declares the confidence is called the "author of the trust":*

the person who accepts the confidence is called the "trustee":….

Term 'beneficiary' and 'instrument of trust' is defined under the MPT Act as follows:

Sec. 2(2A) "beneficiary" *means any person entitled to any of the benefit as per the objects of the trust explained in the trust deed or the scheme made as per this Act and constitution of the trust and no other person (inserted w.e.f. 10-10-2017).*

Sec. 2(7A) "Instrument of trust" *means the instrument by which the trust is created by the author of the trust and includes any scheme framed by a competent authority or any memorandum of association and rules*

and regulations of a society registered under the Societies Registration Act, 1860, to its application to the State of Maharashtra.

Thus this definition covers:

a) the instrument by which the trust is created by the author of the trust

b) any scheme framed by a competent authority

c) any memorandum of association and rules and regulations of a society registered under the Societies Registration Act, 1860, to its application to the State of Maharashtra.

Sec. 2(13) "Public trust" *means an express or constructive trust for either a public religious or charitable purpose or both and includes a temple, a math, a wakf, church, synagogue, agiary or other place of public religious worship, a dharmada or any other religious or charitable endowment and society formed either for a religious or charitable purpose or for both and registered under the Societies Registration Act, 1860.*

This definition covers:

a) An express or constructive trust

b) For either a public religious or charitable purpose or both

c) A temple, a math, a wakf, church, synagogue, agiary or other place of public religious worship,

d) A dharmada or

e) Any other religious or charitable endowment and

f) A society formed either for a religious or charitable purpose or for both and registered under the Societies Registration Act, 1860.

A public trust must be for the benefit of either public at large, or some considerable portion of it, answering a particular description, i.e. the number of beneficiaries should be a fluctuating body.

Public purpose is not capable of precise definition. Whatever furthers the general interest of the community as opposed to the particular interest of the individual must be regarded as public purpose.

It is not necessary that object should be to benefit the whole of mankind or all the persons living in a particular country or province. It is sufficient if the intention is to benefit a sufficiently large section of the public as distinguished from specified individual.

Sec. 2(6) defines **"Hindu"** as follows:-

"Hindu" includes Jain, Buddhist and Sikh;

Sec. 2(10) defines **"Person having interest"** as follows:

Person having interest includes

(a) In the case of a temple

person who is entitled to attend at or is in the habit of attending performance of worship or service at temple OR

who is entitled to partake or is in the habit of partaking in distribution of gifts thereof,

(b) In the case of math

A disciple of a math or

A person of religious persuasion to which math belongs,

(c) In case of waqf

A person entitled to receive pecuniary or other benefit from the Waqf

A person who has right to worship or perform religious right in a mosque, dargah etc

(d) In case of a society registered under 1860 Act

any member of such society,

(e) *In case of any other public trust, any trustee/ beneficiary*

Sec. 2(20) words and expressions used but not defined in this Act (i.e. the MPT Act) and defined in the Indian Trust Act, 1882, shall have the meanings assigned to them in that Act.

Essential e lements for creating a trust

How trust is created - A trust is created when the author of the trust indicates with reasonable certainty by any words or acts:

(a) an intention on his part to create a trust

(b) the purpose of the trust

(c) the beneficiary, and

(d) trust property and

(unless the trust is declared by will or the author of the trust is himself a trustee) he transfers the trust property to the trustee.

It has been held by courts that a trust can be created by word of mouth.

It is also held by courts that - No formal language is necessary to constitute an effective declaration of trust, but the language used must be certain (1) that the settlor intended to constitute a trust binding in law on himself or the person to whom the property is given (2) that he intended to bind definite property by the trust, and (3) that he intended to benefit a definite person or persons in a definite way.

However to avoid future disputes with authorities and to have certainty as to objects and the terms governing the trust it is most desirable to have properly drafted trust deed.

Lawful purpose

Every trust must be for lawful purpose. Section 4 of the Indian Trusts Act, 1882 defines lawful purpose as follows:-

A trust may be created for any lawful purpose. The purpose of a trust is lawful unless it is

(a) *forbidden by law, or*

(b) *is of such a nature that, if permitted, it would defeat the provisions of any law, or*

(c) *is fraudulent, or*

(d) *involves or implies injury to the person or property of another, or*

(e) *the court regards it as immoral or opposed to public policy.*

Every trust of which the purpose is unlawful is void. And where a trust is created for two purposes, of which one is lawful and the other unlawful and the two purposes cannot be separated, the whole trust is void.

Deed of Trust - Declaration of Trust – contents

Important, essential contents discussed below:

Author/settlor - We have seen that the person who reposes or declare the confidence is called author. He settles his property into the trust. He is also called settlor.

Trustee – Permanent – for particular term – The person who accepts the confidence is called Trustee. In case of public trust, there has to be minimum one trustee. There is no limit to maximum number of trustees. Trustees can be for lifetime that is permanent or trustees can be for particular term say for three year, five year etc. Any individual competent to contract can be appointed as trustee. Mode of appointment of trustee should be mentioned in trust deed. It can be hereditary, by succession, by election, surviving/continuing trustees can have right of appointment of subsequent trustee. Having first trustees as life time (permanent) trustees and keeping power of appointment of further trustees with continuing or surviving trustees is a most commonly followed practice.

Transfer of property- There has to be transfer of property by settlor to trustee. Property may be in cash or in kind. It could be as low as ₹ 500/- in

cash. It can be in any other form of movable or immovable property. Generally initial amount of property settled is kept as ₹ 5000/- or ₹ 10000/-.

Office – Office address for the initial period can be address of one of the trustees. Once the trust acquires its own office premises this address can be changed.

Objects – Charitable/public religious - Object of the public trust can be charitable or public religious or combination of both. Private trusts and private religious trusts are not governed by the provision of the MPT Act. See detailed discussion little later. However it should be noted that it is advisable to mention that income and funds shall be spent for specified purpose only, and for the benefit of general public/public at large.

Trust Fund- What it constitutes and how it will be used- applied.

Management – Management of the trust generally vests in the hands of trustee and they have power of management and administration as well as duty to apply the trust fund towards the object of the trust. The trustee shall have power to appoint employee, contractor, agent, representative, attorney, auditor, consultants, to borrow, to acquire property, to sell , alienate trust property, make permissible investments etc.

Meetings – Suitable provision to be made about meetings in the Trust Deed. The MPT Act as well as Indian Trusts Act does not contain any specific provision related to this. Thus periodicity of board of trust meeting whether bi-monthly, quarterly should be mentioned in the Trust Deed. It is possible to have provision like "The Board of trustee shall have meeting for conducting necessary business at such periodicity and frequency as deemed fit by the board." So also there is no specific mention in the MPT Act and Indian Trusts Act about holding annual general meeting.

Accounting Year – Options are - year ending 31st March, 30th June, 31st Dec, Diwali. Trust can have accounting year from 1st April to 31st March, 1st July to 30th June, 1st January to 31st December and Diwali to Diwali. However it is advisable to follow financial year i.e., 1st April to 31st March as accounting year.

Irrevocabilty - It is essential to state that trust as well as trust fund shall always be irrevocable.

Dissolution – Suitable clause may be included as income tax authorities are insisting on it.

Signatures – of settlor and trustees and 2 witnesses

Trustee should sign on each page of Trust Deed like in agreement and at the foot of the Trust Deed there should be signatures of settlor and trustee/s and two witnesses.

Objects/purposes for which a public trust can be formed

Charitable Purpose is defined u/s. 9 of the MPT Act.

As per this definition – charitable purpose shall include

1. Relief of poverty or distress,
2. Education,
3. Medical Relief,
4. Provision for facilities for recreation or leisure time occupation (including assistance for such provision) if these facilities are provided in the interest of social welfare and public benefit.

However there is further condition that–

a. the facilities are provided with the object of improving the conditions of life for the persons for whom the facilities are primarily intended and

b. either–

   (i) those persons have need of such facilities as aforesaid by reason of their youth, age, infirmity or

disablement, poverty or social or economic circumstances OR

(ii) the facilities should be available to the members of public at large,

5. the advancement of any other object of general public utility. However it shall not include a purpose which relates exclusively to religious teaching or worship,

6. provision of facilities at village hall, community centre and women's institutes and provision and maintenance of grounds and building to be used for purposes of recreation and leisure time occupation.

Since it is an inclusive definition it shall cover and include other activities, which can be called charitable, so one has to look at various legal decisions in this respect.

At this stage one should also refer to - keep in mind definition of charitable purpose as per Income-tax Act, 1961 which is as follows:

Meaning of **'Charitable Purpose' [Sec 2(15) of Income Tax Act]**

'Charitable purpose includes

relief of the poor,

education,

yoga w.e.f. 1.4.2016,

medical relief,

preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and

the advancement of any other object of general public utility.

Provided that…..'

A purpose must in order to be charitable, be directed to the benefit of the community or a section of the community, as distinguished from an individual or a group of individuals as held in - ***CIT vs. Ahmedabad Rana Caste Association (1983) 140 ITR 1 (SC).***

Where the primary purpose of the settlor is to benefit the members of his family and relations and only remotely and indirectly the general public, the trust is not a charitable trust.

- Not necessary to benefit whole of mankind
- Not necessary to provide free services
- Cross subsidization permissible

Advancement of Object of general public utility

w.e.f. 1-4-2016 (i.e., w.e.f. A.Y. 2016-17) first and second proviso of sec. 2(15) of Income tax act (Originally incorporated w.e.f. 1-4-2009) are substituted to the effect that advancement of any other object of general public utility shall not be treated as charitable purpose – if it has receipts from commercial activity.

unless -

(i) Such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility, and

(ii) The aggregate receipts from such activity/ activities during the previous year do not exceed 20% the total receipts of Trust/ institution during the previous year.

Definition of charitable purpose under Income-tax Act is also an inclusive definition therefore one should keep in mind important case laws on this subject.

Religious purpose. Religious purpose is not defined under the MPT Act nor it is defined under Income-tax Act. Religious purposes would include the advancement, support or propagation of a religion and its tenets (central principles).

Installation of idols of deity, worship of such deities, celebrating various religious festivals

like Ram Navmi, Mahashivratri, Ganeshutsav, Navratri etc. can be regarded as religious purpose.

Pl. also refer to tribunal judgment in case of S***hiv Mandir Devasttan Panch Committee Sanstan vs. CIT [2013] 56 SOT 456 (Nagpur),*** it says Hindu is neither a religion nor a community. Therefore expenses incurred for worship of Lord Shiva, Hanumanji, Godess Durga and for maintenance of temple cannot be regarded to be for religious purpose.

- Thus trust can be formed for carrying out public religious or charitable or both purposes.
- Cross ref. sec. 80G, 115BBC (anonymous donations) of Income Tax.

Stamp Duty applicable

The trust deed is required to be stamped and the relevant Articles of the Maharashtra Stamp Act as applicable to Maharashtra are Articles 55 and 61 of Schedule I, are as follows:

					Stamp Duty
Article 55	**Settlement**				
	A.	Instrument of settlement			
		(i)		where the settlement is made for a religious or charitable purpose	2% of a sum equal to the amount settled or the market value of the property settled.
		(ii)		in any other case ….	Same duty as is leviable on a conveyance under cl. (a) (b) (c) of article 25
	B.	Revocation of settlement			₹ 500
Article 61	**Trust**				
	A.	Declaration of Trust – of, or concerning, any property when made by any writing not being a Will,			2% of a sum equal to the amount settled or the market value of the property settled
		(a)		Where there is disposition of property,–-	
			(i)	where the trust is made for a religious or charitable purpose;	
			(ii)	in any other case……	the same duty as per conveyance
		(b)		where there is no disposition of the property,–	
			(i)	where the trust is made for a religious or charitable purpose;	₹ 500/-
			(ii)	in any other case …..	₹ 500/-
	B.	Revocation of Trust			₹ 500/-

Registration of Public Trust (Sec 18, 19, 20 & Rule 6)

Once a Public Trust is formed in Maharashtra it is required to be registered under the provision of the MPT Act. Where it is formed as society and registered under the Societies Registration Act, 1860 it is again required to be registered as Public Trust under the MPT Act. Provisions related to registration of Public Trust are broadly as follows:–

1. Application to be made by the trustee to the Dy./Asst. Charity Commissioner of the region or sub-region within the limits of which the trustee has an office for the administration of the trust or the trust property or substantial portion of the trust property is situated, as the case may be.

2. Such application shall be made in writing, in form as per Schedule II. Court fee stamp of ₹ 100/- is required to be affixed to the application.

3. Such application shall be made within 3 months of creation of the public trust.

4. Such application among other things shall contain the following particulars:

   (i) name of the public trust,

   (ii) the names and addresses of the trustees and the manager

   (iii) the mode of succession to the office of the trustee;

   (iv) the list of the movable and immovable property of the trust with descriptions and particulars of the property as may be sufficient for its identification;

   (v) the approximate value of such movable and immovable property;

   (vi) the gross average annual income of the trust estimated on the basis of income of past 3 years. If trust is in existence for less than 3 years, average should be based on number of year's income for which trust is in existence since the creation of the trust.

   (vii) similarly estimated expenditure to be given

   (viii) the address to which any communication to the trustees or manager in connection with the public trust should be sent;

   (ix) such other particulars which may be prescribed:

5. Application for registration shall be signed and verified in the manner prescribed by Rule 6, Sub rule 4 of the MPT Rules by the trustee or his agent specially authorized by him in this behalf. (ss. 6)

6. It shall be accompanied by a copy of an instrument of trust and copy of scheme in operation, (if any).

7. In case a trust at the time of registration owns any immovable property then, along with the application for registration or during registration process, the trustee have to produce an extract from the property register, record of rights and municipal records in order that officer holding the inquiry can ascertain if the property stands in the name of the trustee or the vahivatdar, or whether it stands in the name of a stranger. If it is found out that property is standing in the name of a stranger, it would be the duty of the Dy./Asst. Charity Commissioner to issue notice to such persons and ascertain the facts.

8. Address proof for registered office also required.

9. Copies of photo ID of trustees - self-attested with photos of trustees affixed thereon.

Note:- Public notice – The Dy./Asst. Charity Commissioner generally instructs trustee to publish notice in local news paper.

Affidavit in prescribed format is required to be submitted in the course of inquiry for registration. This affidavit need not be on stamp paper, only court fee stamp of ₹ 10/- is required to be affixed. It can be signed by applicant before superintendent concerned in the office of the Dy./Asst. Charity Commissioner.

Inquiry for registration by Deputy or Assistant Charity Commissioner (Sec. 19)
On the receipt of an application for registration under section 18 of the MPT Act, the Dy./Asst. Charity Commissioner <u>shall make</u> an inquiry in the prescribed manner on various points as stated in this section and ss. 18(5)for the purpose of ascertaining-

1. Whether a trust exists and whether such trust is a public trust?
2. Whether the property as shown in the application is the property of the trust and what is the estimated value of the movable and of the immovable property?
3. Whether the whole or any substantial portion of the subject matter of the trust is situated within his jurisdiction?
4. What is the mode of succession to the trusteeship and managership?
5. What are the objects of the trust?...etc…

Findings of Dy./Asst. Charity Commissioners (Sec. 20)
<u>On completion of the inquiry</u> as provided for under Section 19 the Dy./Asst. Charity Commissioner <u>shall record his findings with the reasons</u> therefore and may make an order for the payment of the registration fee.

On payment of registration fees a certificate of registration is issued under the hand of Dy./Asst. Charity Commissioner.

Under **Section 70** <u>**Appeal**</u> against the findings/ order to Charity Commissioner can be filed within 60 days from the date of order.

Date of Registration of the trust
The date of Registration of the trust shall be date of passing of the order and not from the date of application.

Entries in register (Section 21)
The Dy./Asst. Charity Commissioner shall make entries in the Register of Public Trust kept under section 17 (i.e. in Schedule I) in accordance with the findings recorded by him under section 20.

Public trust created by will (Sec. 29)
In the case of the public trust which is created by a will, the executor of such will shall within one month from the date on which the probate of the will is granted or within 6 months from the testator's death whichever is earlier make an application for the registration in the manner provided in section 18 and all the provisions of the MPT Act & Rules in respect of registration shall apply to the registration of such trust. However in appropriate cases the period prescribed as above for making an application for registration may, for sufficient cause can be extended by the Dy./Asst. Charity Commissioner concerned.

Online Process for Registration

Online process for trust registration is started and application for registration can be submitted online however as on date it is optional and it is advisable to submit application for registration in physical form.

System of coding trust
In the records of Office of Charity Commissioner a system of coding is followed as follows:

A. Hindu Religious

B. Muslim Religious

C. Parsee Religious

D. Christian/Jew Religious

E. Trust registered on the basis of Trust Deed

F. Societies registered under 1860 Act registered as trust

Formation of Societies

Societies formed by Memorandum of Association and Rules and Regulations under the Societies Registration Act, 1860

This is another prevalent form of forming a charitable/public religious organization.

'Sec. 1 Any seven or more persons associated for any literary, scientific or charitable purpose, or for any such purpose, as is described in Section 20 of this Act, may by subscribing their names to a Memorandum of Association, and filing the same with the registrar form themselves into a society under this Act.'

<u>Sec. 20 To what societies Act applies</u>

'ss. (1) The following societies may be registered under this Act:-

Charitable societies, the military orphan funds or societies established at the several presidencies of India, societies established for the promotion of science, literature, or the fine arts, for instruction, the diffusion of useful knowledge, the diffusion of political education, the foundation or maintenance of libraries or reading-rooms for general use among the members or open to the public, or public museums and galleries of paintings and other works of art, collections of natural history, mechanical and philosophical inventions, instruments or designs.'

However it should be noted that political purpose is not regarded as charitable purpose.

Contents of the Memorandum of Association

1. Name of the Society
2. Office Address
3. Object of the Society
4. Members Addresses, Designation, Age and Occupation
5. Affirmation

Contents of the Rules and Regulations

Rules and Regulations of a society formed for charitable or religious or other purposes contains following clauses -

1. Definition
2. Jurisdiction
3. Financial Year
4. Membership - minimum 7
5. Types of Members
6. Ceasing to be a Member
7. Managing Committee
8. Power of the Managing Committee
9. Meeting of the Managing Committee
10. Quorum for the Managing Committee
11. Minutes to be kept
12. Office Bearers and their duties
    i) President
    ii) Secretary
    iii) Treasurer
13. General Body Meeting
14. Extra Ordinary General Body Meeting
15. Notice of the General Body/Extra Ordinary General Body Meeting
16. Business of the Annual General Meeting
17. Quorum of the General Body Meeting

18. Election
19. Source of Income and its application
20. Bank Account
21. Sub Committees
22. Books of Account
23. Provision regarding sale and purchase of Immovable Property
24. Provision regarding Loans & Deposit
25. Membership register to be kept
26. Custody of the Documents
27. Provision for Amendments in Rules & Regulation
28. Provision for change in name and object of the society
29. Dissolution

Note - since Societies Registration Act do not contain specific provisions about most of the items of rules and regulation it can be drafted to suit requirement of organization.

Documents required at the time of Registration of the Society

1. Application letter
2. True copy of Memorandum of Association
3. True copy of the Rules & Regulations
4. Consent letter duly signed by all the Members of the Managing Committee (under both the acts)
5. Authority letter duly signed by all the Members of the Managing Committee (under both the Acts)
6. Affidavit/self declaration in standard format
7. Resolution in standard format
8. Address proof for registered office & NOC of owner
9. Copies of photo ID of managing committee members with photos of members affixed thereon.
    - Application in Sch. II duly notarized with ₹ 100/- court fee stamp also reqd. to be affixed.(as society is later on registered as trust)
    - Two sets are required to be submitted.
    - Exemption from publication of paper notice:-Application for granting exemption from publication of paper notice can be submitted and is allowed by the Asst. Registrar concerned.
    - Online Application:- Option for online submission of society registration application is available.
    - Once society is registered under the Societies Registration Act 1860 it is compulsorily required to be registered as public trust under provisions of the MPT Act.

Registration of Section 8 Company under Companies Act

A charitable institution/association may be registered as a non-profit company and can obtain a license under section 8 of the Companies Act 2013. Such company is registered without addition of word 'Limited 'or 'Private Limited' to its name.

A Non-profit making Company is a Company which:

(a) has in its objects the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object;

(b) intends to apply its profits, if any, or other income in promoting its objects; and

(c) intends to prohibit the payment of any dividend to its members.

Procedure for registration of Non-Profit making Company

Procedure for getting License under section 8 for new companies with charitable objects is given in rule 19 and 20 of Companies (Incorporation) Rules, 2014 which is as follows:

Obtain Digital Signatures

It is necessary to obtain a Class II Digital Signature Certificate for at least one director to sign the E-forms related to incorporation like form Spice 32 and INC 12 for obtaining licence.

Obtain Director Identification Number (DIN) [Section 153]

As per sec. 153 of the Companies Act, 2013, every individual intending to be appointed as director of a company shall make an application for allotment of DIN in form DIR.3 to the ROC along with prescribed fees.

The license may be granted to new company as well as to existing companies. The procedure in each case shall be as under:

(a) ***New company*** : The proposed company should make an application for reservation of name to the ROC in RUN Application and follow the guidelines issued in this regard.

After reservation of name make application for license in the Form INC-12 along with the following documents:

(i) Memorandum and Articles of Association of the proposed company (refer Form INC-13 for form of Memorandum). No stamp duty is payable on the Memorandum and Articles of Association of a company to be registered under these provisions.

(ii) Declarations in form INC-14

signed by an advocate, or a Chartered Accountant, or a Cost Accountant, or a Company Secretary in whole time practice in India, who is engaged in the formation of company.

(iii) Declaration signed by each of the applicants in Form INC-15.

(iv) List of names, addresses, description and occupation of the promoters.

(v) List of proposed Directors and Key Managerial Personnel.

(vi) An estimate of future annual income and expenditure of the company for next 3 years, specifying the sources of income and objects of expenditure.

(vii) Approval/concurrence/NOC of the concerned authority/sectoral regulator, department or Ministry of Central/State Government(s). (if required due to nature of activity)

Fee : The fee for filing application is ₹ 2000, which may be paid either electronically or in government treasury through challan.

Grant of License: The license is granted by the Registrar after the scrutiny of the application. The Registrar may direct the company to incorporate in its memorandum or articles or both, such conditions as may be specified by the Registrar in this behalf. License shall be in form INC 16.

Registration: after getting license u/s. 8 company has to make an application for registration with ROC in Form SPICe (INC 32) with attachments as required.

(b) ***Companies already Registered*** : A limited company registered under the act or under any previous company law, with objects of charitable nature, desirous of obtaining license under section 8 of the Act, should apply to ROC concerned, in Form INC-12 along with:

i) Memorandum and articles of association

ii) Declaration in Form INC-14 signed by:

An advocate or a Chartered Accountant or a Cost Accountant or a Company Secretary whole time practicing in India who is engaged in the formation of company,

iii) Declaration signed by each of the applicant in Form INC-15.

iv) Financial Statements (i.e. Profit & Loss account, Balance Sheet and Cash Flow statement), report of Board of Directors and audit report of the company for each of last 2 financial years. (If the company is in existence for less than two years, documents relating to one year only may be submitted.)

v) A statement of assets and liabilities of the company, with their values, as on the date of application or within 30 days before that date.

vi) An estimate of future annual income and expenditure of the company for next 3 years.

vii) Certified copies of Board/General Meeting resolutions approving registration of company u/s 8.

viii) List of names and addresses, description and occupation of directors, managers or secretary/key managerial personnel.

Fee on application: Same provision as for new company.

Notice to be published: Within a week after making application to the Registrar, a notice is required to be published - in English and one vernacular newspaper of the area where the registered office is situated and on the websites notified by the Central Government.

Grant of Licence: The licence is granted by the Registrar after the scrutiny of the application, and after considering the objections, if any, received by it within 30 days from the date of publication of notice. The registrar may require the company to furnish approval/concurrence of any appropriate authority, regulatory body department or Ministry of Central/State Government. Licence shall be in form INC 17.

The registrar may direct the company to incorporate in its memorandum or articles or both, such conditions of the license as may be specified by him in this behalf.

If there is change in memorandum/articles, as advised by the Registrar while granting license u/s 8, the same will be incorporated and the amended memorandum/articles should be filed with the Registrar along with the requisite filing fee.

- Requirement of minimum paid up capital is not applicable to section 8 company.
- No restriction on maximum no of directors - Restriction on maximum no of directors to 15 is not applicable. Notification dt. 13-6-2017.
- No requirement of Independent Directors.
- May hold only one Board Meeting in every 6 calendar months.
- See notification No. GSR 466(E) dt. 5-6-2015 as amended by notification No. GSR 584(E) dt. 13-6-2017 for privileges of section 8 company.

- For non compliance with any of the requirements of section 8 – fine of ₹ 10 lakhs to ₹ 1 Cr. to company and fine of ₹ 25,000 to ₹ 25 lakhs to directors, and imprisonment up to 3 years or both. [sec. 8(11)]

Which form to choose- Trust or society forms are popular in Maharashtra for purpose of carrying out charitable or religious activity. Some prefer sec. 8 company form. Choice of the form of organization should be done very carefully considering pros-and-ons of each form.

Important Compliance under the MPT Act

Once a Trust or Society is registered next comes the question of important, essential compliance under the provisions of the MPT Act, which are as follows-

Submission of Change Report (Sec. 22 & Rule 13)

1. Where any change occurs in any of the entries recorded in the Register of Public Trusts in Form of Schedule I, maintained by the office of Dy./Asst. Charity Commissioner, the trustee shall within 90 days from the date of the occurrence of such change, report such change to the concerned Dy./Asst. Charity Commissioner. Such change report shall be in the Form of schedule III and shall be verified in the manner provided in sub rule (4) of Rule 6.

2. The Dy./Asst. Charity Commissioner may hold an inquiry in the prescribed manner for the purpose of verifying correctness of entries in the register kept u/s. 17 or for ascertaining whether any change has occurred in any of the particulars recorded in the register.

3. If the Dy./Asst. Charity Commissioner, is satisfied that: -

   (a) a change has occurred in any of the entries recorded in the register kept under section 17 in regard to a particular public trust, or

   (b) that the trust should be removed from the register due to the reason that the office of the administration of the trust and the whole of the trust property ceasing to be situated in the State,

   he shall record a finding with the reasons therefore to that effect; and if he is not so satisfied, he shall record a finding with reasons therefore accordingly.

Any such finding shall be appealable to the Charity Commissioner.

- The Dy./Asst. Charity Commissioner shall amend or delete the entries in the Register of Public trusts in accordance with the finding, and if appeals or applications were made against such finding, the Dy./Asst. Charity Commissioner shall amend or delete the entries in the said register in accordance with the final decision of the competent authority provided by the Act. The Dy./Asst. Charity Commissioner may of his own motion correct clerical or accidental mistakes in the entries in the register under section 17.

- Procedural requirements – Form Schedule III – court fees stamp of ₹ 100 to be affixed - copy of resolution of appointment- record of attendance at meeting - copy of resignation - copy of death certificate - copy of minutes in case of election/ appointment made in meeting – NOC of outgoing Trustees – consent of incoming trustees – delay condonation letter in case of delay in filing of change report .

The following points should be noted

- Though Section 22 talks about any change, however in my opinion change report needs to be filed on changes in managing

committee, changes in trustee, acquisition of immovable property and for such major changes only.

- Old body does not continue automatically for delay or due to non-filing of change report by new body.
- It is well-settled that court should be liberal in condoning the delay. It is not necessary to explain each day's delay.

Deregistration of trust

Registered Trust can be deregistered as per following new sub-sections (3A) & (3B) of Sec. 22 as follows –

"(3A) The Deputy or Assistant Charity Commissioner <u>may</u>, <u>after</u> such <u>detailed and impartial inquiry</u> and following such procedure as may be prescribed, de-register the trust on the following grounds :-

(a) When its purpose is completely fulfilled; or

(b) When its purpose becomes unlawful; or

(c) When the fulfilment of its purpose becomes impossible by destruction of the trust-property or otherwise: or

(d) When the trust, being revocable, is expressly revoked; or

(e) When the trustees are found not doing any act for fulfilling object of the trust:

Provided that .... "trust can be deregistered under clause (e) in case trustees have committed default in reporting the change or in submission of the audited accounts or in making any other compliance prescribed by or under this Act for a period of five years from the last date of reporting the change, submission of the accounts or making the compliance.

Further ss. (3B) says in case trust is deregistered, the Dy. or Assistant Charity Commissioner may take over the management of properties of the trust de-registered under sub-section (3A) and pass such necessary orders for the same as he deems fit and may, if he considers it expedient, dispose them of by sale or otherwise and deposit the sale proceeds in the Public Trusts Administration Fund established under section 57."

Rule 12A- gives procedure to be followed by the Dy./Assistant Charity Commissioner for deregistration.

Submission of budget by Public Trust (Section 31A & Rule 16A)

Trustees of certain trusts are required to submit budget to Charity Commissioner. Relevant provisions are are as follows: -

- A trustee of a public trust, which has an annual income exceeding

  (a) ₹ 5,000/- in the case of a trust for a public religious purpose, and

  (b) ₹ 10,000/- in other cases shall,

  At least one month before the commencement of each accounting year, prepare and submit to the Charity Commissioner, a budget in form VII-A showing the probable receipts and disbursements of the trust during the following year.
- Every such budget shall make adequate provision for carrying out the objects of the trust, and for the maintenance and preservation of the trust property.
- Enclose true copy of resolution passed by Board of Trustees sanctioning the budget.

Maintenance of Accounts: (Section 32 & Rule 17)

Every trustee of a public trust is required to maintain regular account of:

a. All recepts and payments

b. Movable and immovable property

c. All encumbrances on the trust property and

d. Alienation of trust property

- Public trusts having Gross Annual Income above ₹ 5,000/- are required to get their accounts audited from a chartered accountant . Prescribed Form of Balance Sheet is Sch. VIII, Form of Income and Expendiure Account is Sch. IX, Form of Statement of Income liable for contribution is Sch. IX-C. Truustee and or auditor should file the same with office of Dy./Asst. Charity Commissioner concerned (now online). Audit should be completed within 6 months from the end of the accounting year and Audit Report, Audited B/S and Income & Exp. A/c to be filed with ACC office within a fortnight of audit.

- Public trusts having Gross Annual Income up to ₹ 5,000/- are not required to prepare Balance Sheet and Income and Expenditure Account in form of Schedule VIII and IX. Trustee's of such Public Trust can prepare and file (online) statements in the Form of Schedule IXA and IXB, with a copy of pass book within 3 months from the end of the accounting year.

- As per circular issued by the Charity Commissioner on 22nd June 2017, Annual Audited Accounts i.e., Balance Sheet, Income and Expenditure Account, Audit Report are required to be filed online.

- Due to representations made to authorities, submission of sch. IXD is not required as of now.

- Guidelines regarding online filing is available on website of charity Commissioner-- www.charity.maharashtra.gov.in

Other related sections and rules pertaining to audit are:-

Section 33. Balancing and auditing of accounts

Rule 18. Certain powers for facilitating audit

Section 34. Auditor's duty to prepare balance sheet and to report irregularities,

Rule 19. Contents of auditor's report

Rule 21. Time for audit and submission of the audit report, etc. under section 34.

Investment of public trust money (Section 35)

1. Where the trust property consists of money and it cannot be applied immediately or at any early date to the purposes of the public trust the trustee shall, notwithstanding any direction contained in the instrument of the trust, deposit the money in:

   (a) Any Scheduled Bank as defined in the Reserve Bank of India Act, 1934,

   (b) in the Postal Savings Bank or

   (c) in a co-operative bank approved by the State Government for the purpose or

   (d) to invest it in public securities.

   Public securities have been defined u/s 2(12) as follows: -

   "Public securities" means-

   (a) Securities of the Central Government or any State Government;

   (b) Stocks, debentures or shares in Railway or other companies, the interest or dividend on which has been guaranteed by the Central or any State Government;

   (c) Debentures or other securities for money issued by or on behalf of any local authority in exercise of the powers conferred by an Act of the Central or State Legislature;

(d) *A security expressly authorized by an order, which the State Government makes in this behalf;*

(e) *in the first mortgage of immovable property situate in any part of India provided property is not leasehold for a term of years and the value of the property exceeds by one-half of the mortgage money (i.e. if mortgage money is ₹1 lakh value of property should be more than ₹ 1.50 lakh)*

Exception: Above stated restriction are not applicable in cases any investment or deposit already made before the coming into force of the Bombay Public Trusts (Amendment) Act 1954 and that such investment or deposit is made in accordance with a direction contained in the instrument of the trust.

2. Apart from this the Charity Commissioner may by general or special order permit the trustee of any public trust or classes of such trusts to invest the money in any other manner.

Alienation of immovable property (Section 36 & Rule 24)

Provisions related to alienation of immovable property of public trust are contained in Section 36 & Rule 24 which are as follows: -

1. Notwithstanding anything contained in the instrument of trust previous sanction of the Charity Commissioner is must-

   a. for sale, exchange or gift of any immovable property belonging to the trust and for granting lease for a period exceeding 10 years in the case of agriculture land or for granting lease for a period exceeding 3 years in the case of non agriculture land or a building belonging to a public trust,

   Application is required to be made to the Charity Commissioner for getting such sanction. The Charity Commissioner may give such sanction subject to such condition as the Charity Commissioner may think fit to impose, regard being had to the interest, benefit or protection of the trust; [Sec 36(1)(a)&(b)]

   Amendment wef. 10/10/2017 lease period should not exceed 30 years.

   b. Similarly for disposing of any immovable property of the trust an application is required to be made to the Charity Commissioner. On such application the Charity Commissioner may authorize any trustee to dispose of such property. However the Charity Commissioner may impose such conditions as he thinks fit to impose, regard being had to the interest or benefit or protection of the trust. [Sec 36(1)(c)]

2. The Charity Commissioner can revoke the sanction given for sale exchange, gift or for granting lease as stated in para.1a above on the ground that such sanction was obtained by fraud or misrepresentation made to him or was obtained by concealing from the Charity Commissioner, facts material for the purpose of giving such sanction. In such case he can further direct the trustee to take such steps for recovery of the property within a period of 180 days from the date of revocation or within such further period not exceeding in the aggregate one year as the Charity Commissioner may from time to time determine.

3. However before revoking such sanction the person in whose favour such sanction has been made shall be given a reasonable opportunity to show cause why the sanction should not be revoked.

4. If the Charity Commissioner is of the opinion that the trustee has failed to take effective steps within period specified or it is not possible to recover the property with reasonable effort or expense the Charity Commissioner may assess any advantage received by the trustee and direct him to pay compensation to the trust equivalent to the advantage so assessed.

Powers and duties of, and restrictions on, trustees (Section 36A)

- *Previous sanction to borrow*:- Trustee shall not borrow moneys (whether by way of mortgage or otherwise) for the purpose of or on behalf of the trust , except with the previous sanction of the Charity Commissioner. The Charity Commissioner while according such sanction may impose such conditions and limitations in the interest or protection of the trust as he deems fit. By the MPT (Amendment) Act, 2016 provision is added to ss (3) **w.e.f. 23rd February, 2016. –**

  As per this provision the Charity Commissioner or the Joint Charity Commissioner shall decide the application for borrowing money from the Bank or Financial Institution forthwith and preferably within a period of 15 days, if the Bank or the Financial Institution has provisionally sanctioned the loan. (ss. 3)

- *Restriction on borrowing:* - No trustee can borrow money for his own use from any property of the public trust of which he is a trustee. (ss. 4)

- **Amendment to Section 36A** - Regarding borrowing from Nationalised/Scheduled Bank- ex post facto sanction– w.e.f. 10/10/2017

The Charity Commissioner may grant *ex-post facto* sanction to borrow moneys from any nationalized bank or the Scheduled Bank, by the trustees in case of hardship to trust, beneficiary or bona fide third party. (ss. 3A inserted)

Register of movable and immovable properties (Section 36B & Rule 24A)

A public trust is required to maintain register of movable and immovable properties owned by it. Related provisions are as follows:–

1. A public trust shall prepare and maintain a register of all movable and immovable properties (not being property of a trifling value) of such trust in form of schedule X-AA.

2. Such register shall show the jewels, gold, silver, precious stones, vessels and utensils and all other movable property belonging to trust with their description, weight and estimated value.

3. Such register shall be prepared within three months from the expiry of the accounting year.

4. Every year within 3 months from the date of balancing the accounts, the trustees or any person authorized by him shall scrutinize such register, and shall bring it up-to-date by showing alterations, omissions or additions to the same.

5. Such register shall be signed by all trustees or by any person duly authorized by trustees in this behalf after verifying its correctness.

6. Such register shall be made available to the auditor for the purpose of auditing if the accounts are required to be audited.

7. The auditor shall mention in the audit report whether such register is properly maintained or not, and the defects or inaccuracies, if any, in the said register. The trustees shall comply with the suggestions made by the auditors and rectify the

defects or inaccuracies mentioned in the audit report within a period of three months from the date on which the report is sent to the trustees.

Power of the Charity Commissioner and State Government to issue directions in respect of hospital, etc. to earmark certain beds etc., for poorer patients to be treated free of charge or at concessional rates (Section 41AA & Rule 25A)

The Charity Commissioner subject to orders issued by State Government in this respect can issue directions for earmarking certain beds, facilities etc for poor and indigent patients. Division Bench of Bombay High Court has approved scheme under this section.

Indigent patient means, whose annual income is below ₹ 85,000/-.

Weaker section patient means, whose annual income is from ₹ 85,000/- to ₹ 1,60,000/-.

Indigent patients are to be treated at free of cost and weaker section patients to be charged concessional rate.

The Governing body of a medical center referred to in section 41AA of the MPT Act, shall maintain a register for recording the category of a patient, in the form of Schedule X-AAA.

"S. 41C. Persons (other than public trust) collecting money, subscription or donation, etc. (substituted w.e.f. 21-5-2018)

As per this section unregistered associations should take temporary permission from the office of charity commissioner for making collection of funds for Ganeshotsav, Navaratri, in natural calamities etc. Online process is available for this purpose.

See new sec. 66C for punishment for contravention of sec. 41C 3 months imprisonment … fine 1½ time of amount collected.

S. 41F. Attachment of property in certain cases (inserted w.e.f. 21/5/2018)

a. Where it is brought to the notice of the CC by any Asst. CC or the Dy. CC or two or more persons having interest in the trust property that disobedience of any of the orders passed under any of the sections in the Chapter VI (i.e. sec 37 to 41F) is committed, the CC after hearing the parties concerned, may order the property of such person guilty of such disobedience or breach, to be attached and may also order such person to be detained in jail for a term not exceeding 6 months. Such attachment shall remain in force for maximum one year period, at the end of which time, if the disobedience or breach continues, the property attached may be sold, and out of the proceeds, the CC may award compensation as he thinks fit, and shall pay the balance, if any, to the person entitled thereto...

b. A trustee or a person against whom the order under this section is passed, may, within 90 days of the date of communication of each order, appeal to the High Court against such order".

Rule 25AA prescribes procedure for execution of order passed u/s. 41F

Contribution to the Charity Commissioner (Section 58)

No contribution is being collected by Charity Commissioner office now in view of court order. Order of Bombay HC in CA No. 1 of 2009 PIL No. 40,1780, and 1864 of 2007.

Penalties (Section 66)

Maximum fine of ₹ 10,000 is payable on–

failure to apply for registration within time,

failure to report a change,

failure to keep regular accounts,

failure to pay contribution,

failure to invest money in Public Securities,

failure to send memoranda of immovable property within time etc.

Punishment for contravention of provisions of Section 36 (Sec 66A)

Where anyone alienates or attempts to alienate immovable property of the trust, without previous sanction of the Charity Commissioner can be punished with simple imprisonment, which may extend to 6 months and fine, which may extend to ₹ 25000/- or with both.

Punishment for contravention of provision of Sec 41AA- (Sec 66B)

Failure without reasonable cause to comply with Sec. 41 AA (i.e. reserving hospital beds for poor patients etc) attracts penalty, which may extend to ₹ 20,000/- and simple imprisonment, which may extend to 3 months or both.

Section 66C inserted w.e.f. 21-5-2018

S. 66C. Punishment for contravention of section 41C

Whoever collects money donation etc. without prior permission or prior without intimation as specified under section 41C shall, on conviction, be punished with simple imprisonment for a term which may extend to 3 months or with fine, which may extend to 1½ times the amount or contribution collected.

Penalty for contravention of other provisions of Act or Rules (Sec 67)

For contravention of any of the MPT Act or Rules or for failing without reasonable cause to comply with any order passed or direction issued under the provisions of the Act by the Charity Commissioner, Joint Charity Commissioner or Dy./Asst. Charity Commissioner. A fine up to ₹ 10000/- can be levied.

Compounding of offence (Sec 67A)

Compounding of offence is possible by officer not below the rank of Assistant Charity Commissioner in fit cases; composition amount shall not exceed ¼th of the maximum amount of fine provided under the respective sections.

Website of charity commissioner – www.charity.maharashtra.gov.in – may be referred for useful information.

Registration with NITI AAYOG

All NGOs, which receive foreign donations, have been directed by the Home Ministry to register themselves with a platform offered by the Niti Aayog to ensure better transparency, efficiency and accountability. Existing NGOs, which were registered under the Foreign Contribution Regulation Act, and those which are seeking registration or prior permission or accepting foreign contributions are required to register with the DARPAN portal of the Niti Aayog.

For any FCRA related services like registration, prior permission, renewal, change details, uploading of annual return etc., NGO shall require unique DARPAN identification number. Other NGO's if seeking or getting Govt. grants will have to register on this portal.

The portal enables NGOs to enroll centrally and thus facilitates creation of a repository of information about NGOs sector-wise. It facilitates NGOs to obtain a system generated unique ID as when signed. As on date 85,207 NGO's consisting of trusts, societies, Pvt. sec 8/25 companies, educational institutions are registered on the potal. DARPAN provides space for interface between the voluntary organisations/NGOs and key government ministries, departments and government bodies. The platform has been started to bring about greater partnership between NGOs and the central government. The portal is presently managed by the NITI Aayog.

Who are eligible to Register under Niti Aayog

Any NGO which is registered as a trust/society/a private limited non profit company, under section 8/25 is eligible to get Registered with Niti Aayog. As of now no individual (person) registration is allowed.

Who are required to be Registered under Niti Aayog

It is mandatory for NGO to get enrolled before getting any grant from Government Departments or if they are registered/required to obtain registration/prior permission under FCRA.

Steps for NITI Aayog Registration

1. Visit – https://ngodarpan.gov.in/

2. Click on Login/Register Link and click on Sign up Option.

3. Provide Name of NGO/VO, Contact Person Mobile Number and Contact Person Mail ID. Put Security Code and submit the request and after that provide PAN detail of NGO/VO.

4. OTP is sent on given mobile number and Mail ID. After verification of OTP, one will have to generate password for further Login purpose.

5. Thereafter come to Home page and use Sign in option for login purpose. Enter your login ID and password.

6. After login, you will find PAN number and name of NGO/VO as pre-filled.

7. Now provide following further details.

   a. NGO Address

   b. NGO/VO Registration authority (Under which Act NGO/VO is registered)

   c. Registration Number and upload Registration Certificate Copy for verification purpose.

   d. Act Name and Date of Registration under this Act.

   e. All other registration details, if registered like. FCRA Registration, GST Registration etc.

8. Provide at least 3 Members detail of Trustee/Executive Committee/Founder Members/Office Bearers as on date of application.

9. Provide details of all sources of funds, received from Government bodies in Last 5 years.

10. Provide detail of key person, who can be contacted in case of any query.

11. Provide details relating to NGO/VO Core area of working with state detail.

12. When you provide all these details your profile is 100% complete and then submits the application.

13. After submission of your application, your file is sent for processing to the concerned officer.

14. After verification of your documents, the officer will approve your application or ask for another document if required.

15. When your application is approved, you will be allotted a Unique Id, which will be used in future for all correspondence purpose with Government.

It will take approx. 3-5 days time for approval of your application.

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Prevention of Money Laundering Act, 2002 ["PMLA"] applicable to NGOs/NPOs

CA Bhavesh Vora

1. Introduction

What are NGOs/NPOs?

Non-Government Organisations ["NGO"] or Not for Profit Organisations ["NPOs"] are umbrella terms used to refer to all non-profit entities that operate independently of government influence.

The Prevention of Money-laundering (Maintenance of Records) Rules, 2005, made under the Prevention of Money Laundering Act, 2002 ["PMLA"] define a Non-Profit Organisation as *"any entity or organisation that is registered as a trust or a society under the Societies Registration Act, 1860 (21 of 1860) or any similar State legislation or a company registered under section 8 of the Companies Act, 2013 (18 of 2013)".*

NGOs/NPOs are set up for several purposes such as promoting social or political change, conserving the environment, providing education or healthcare facilities, protecting human rights, etc. They play an important role, particularly in developing countries such as India in acting as a support system for the government, in achieving its social and development goals. A lot of these NGOs/NPOs take the form of religious organisations, carrying out religious activities along with other altruistic activities.

What is Money Laundering?

Money Laundering is the activity of converting 'tainted money' or money that is obtained as the result of some illegal activity into money that appears legitimate. It is the process that is used to disguise its illicit origins. This process allows the Money-Launderer to ultimately enjoy these ill-gotten gains, without any worry that they will be traced back to the crime that it resulted from.

The activity of Money-Laundering is generally carried out in three phases:

a. Placement

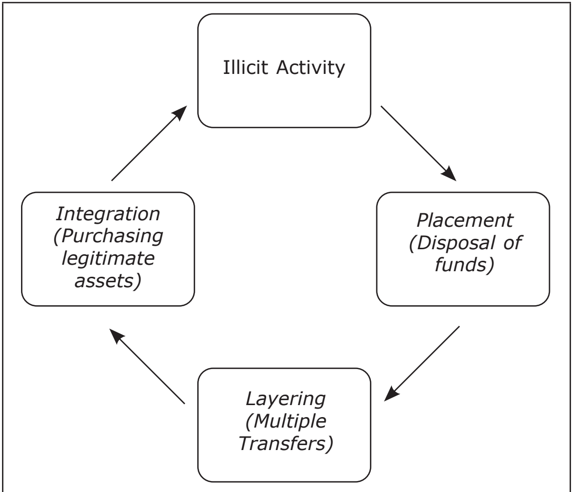
b. Layering, and

c. Integration

The **Placement** phase is the movement of funds from its source, into elements of different amount and nature. On account of this step, the source and origin of funds can be disguised or misrepresented. In this phase, the "dirty money" is placed in the legitimate financial system.

Layering stage involves making it more difficult to detect and uncover a laundering activity. It is meant to make the trailing of illegal proceeds difficult for the law enforcement agencies, through series of transactions and bookkeeping tricks.

In the **Integration** step, previously laundered money is circulated into the economy, mainly through the banking system, or the financial/capital markets, and thus such monies appear to be normal business assets.



Vulnerable by its Nature

NGOs/NPOs tend to enjoy higher levels of public confidence on account of their selfless goals. In the Indian context this level of public confidence is even more greatly heightened in the case of organisations with religious motives.

The operations of NGOs/NPOs are largely dependent on voluntary contributions, which results in uneven and unpredictable cash flows. This offers attractive possibilities in all stages of money laundering, since detection of suspicious transactions becomes difficult.

Since the providers of the funds [the "Donors"] and the beneficiaries are entirely separate entities, the donors do not expect to be able to see any direct results of their contributions. Because of these reasons, people are not likely to be overly surveillant or instantly suspicious of any of the activities that are carried on by such organisations.

A large section of these organisations do not fall under the purview of any sort of regulatory supervision, and therefore a lot of activities carried out by these organisations are not subject to any sort of scrutiny. This is becoming particularly evident in the backdrop of a lot of countries tightening their supervision of such organisations. The lack of regulatory scrutiny makes such organisations a magnet for Money-Laundering Activities.

2. History of PML Regulations for NGOs/ NPOs

In June 2010, the Financial Action Task Force ["FATF"] issued the Mutual Evaluation Report, which focused on deficiencies in the regulatory environment for combating terrorism financing.

The report stated *"There has been no effective outreach to the NPO sector by the Government of India or by State Governments in relation to risks and vulnerabilities of the sector to terrorist financing abuse."* and also stated that *"Except for NPOs registered with the Income Tax Department and under the Foreign Contribution Regulation Act, 2010 ["FCRA"], India's NPO sector is not well organised, monitored and supervised. India concentrates most of its efforts on tax exempt NPOs as well as those receiving foreign contributions, but these NPOs only account for a small number of entities within the sector."*

Recommendation was provided by the above report for NGOs/NPOs being vulnerable to terrorist financing abuse.

In response to the recommendations, a Non Profit Organisations Sector Assessment Committee was set-up. The follow-up report of FATF on Mutual Evaluation of India pointed out that while some issues were completely addressed, others were only partially addressed.

3. PMLA and NGOs/NPOs

The NGOs/NPOs in India are following the guidelines that focus mainly on tax compliances. The regulator's approach towards NGOs/NPOs is to monitor the non-compliances mainly relating to taxation, and lesser towards money laundering activities. The longstanding view held is that the terrorism financing risk in the NGO/NPO sector mainly relates to the receipt of funds from abroad. This particular aspect is regulated by the Foreign Contribution Regulation Act, 2010 ["FCRA"]. Though FCRA has necessary checks and balances to identify large sums of foreign funding being deployed in India through NGOs/NPOs, much still needs to be done.

The Prevention of Money Laundering Act, 2002 and the rules framed thereunder, focus on indirect monitoring of NGOs/NPOs, through the accounts they maintain with reporting entities ["RE"].

PMLA defines 'Reporting Entity' as *"a banking company, financial institution, intermediary or a person carrying on a designated business or profession."* The REs are responsible for reporting *"All transactions involving receipts by non-profit organisations of value more than Rupees Ten Lakh, or its equivalent in foreign currency"* in Non-Profit Organization Transaction Report ["NTR"], which is to be submitted by 15th day of the succeeding month.

It may, however, be noted that REs are to report on transactions that are suspicious and cash transactions, and furnish other reports as prescribed, in addition to NTR report. This, in addition to the risk of illicit funds being deployed into the financial system, leads to majorly all financial institutions classifying accounts of NGOs/NPOs as 'High Risk'.

Section 3 of the PMLA states that *"whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected to proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of offence of money-laundering."*

Though the PMLA does not prescribe any Anti Money Laundering rules or regulations for NGOs/NPOs, the definition of Money-Laundering is wide enough to convict any NGOs/NPOs who carry out any of the aforementioned activities.

PMLA also provides for officers of other government departments and agencies to be empowered and required to assist in enforcement of PMLA. Therefore, any data shared with the Income-tax department and with other regulatory bodies, can also be shared with the authorities of PMLA.

Further, PMLA also provides for provisions relating to:

- Attachment of property in case there is reason to believe that the person is in possession of proceeds of crime

- Be subject to a survey under the Act
- Be subject to a search and seizure under the Act

The Finance Act, 2019 has provided powers to PMLA to the extent that for Survey, Search and Seizure, the authorities are not required to follow procedures to obtain arrest warrant, and the requirement of filing FIR before arrest has been done away with.

4. Stakeholders of NPOs/NGOs

Section 70 of the PMLA titled "Offences by Companies" provides what individuals would be held responsible in the case of such offences. Though the title of the section specifies 'Companies', an explanation to the section says that "company" means any body corporate and includes a firm or other association of individuals. Therefore, the provisions of the section will be made applicable to NGOs/ NPOs existing within the structure of Trusts and Societies as well.

According to this section, in case of companies, every person who at the time the contravention was committed, was in charge of, and was responsible to the company, for the conduct of the business of the company shall be deemed to be guilty of the contravention, along with the company.

This section acts as a deterrent for the person responsible for the conduct of the activities and will make them less likely to connive in activities that are against the provisions of this law. It will also lead to them maintaining higher standards of due diligence over the operations of the entities. In the case of trusts, their trustees would be the people who are responsible for steering the overall conduct of the business. Trustees are in a fiduciary capacity towards the beneficiaries of the trust and it is the responsibility of the trustees to carry out all activities based on the indenture of trust.

However, this section shall not render a person liable to punishment if he/she proves that the contravention took place without his/her knowledge and also that he exercised all due diligence to prevent such contravention.

This can be evidenced in multiple ways, such as by the existence of a management committee to whom all the daily activities have been delegated, set out the processes/ procedures and establish an authorization matrix, Internal controls mechanism which is regularly reviewed and audited, etc. However not all responsibility can be delegated to such management committee or delegates, and the upper levels of management must carry out the necessary supervisory activities.

Persons, other than those directly responsible for the control and management of such organisations, may also be directly or indirectly involved in the activities of Money-Laundering. It becomes necessary to examine how the PMLA will be made applicable to such entities.

- The implication of the PMLA will also be on the persons who donate in such NGOs/NPOs since there may be persons who sourced these 'proceeds of crime' and who may be making use of these organisations for the purpose of carrying out money laundering activities, maybe for their benefit.

- When these NGOs/NPOs can be used for the 'Layering' stage of money laundering, often the 'tainted money' of the Money-Launderer would be remitted back to such person as 'clean money' by using fictitious or over inflated payments to be made by the NGOs/NPOs to entities directly or indirectly controlled by such Money-Launderer.

- Unlike Corporates, at times the controls are not effective in NGOs/NPOs. On account of this, some employees who manage the operations utilise these deficiencies and connive to help carry out the Money-Laundering activity, often for a commission. Such employees will also be held guilty of the offence of Money-Laundering.

Penal Provision under PMLA

A person convicted of the offence of Money-Laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years, but which may extend to seven years and shall also be liable to fine. In case the proceeds pertain to any crime specified under Para 2 of Part A of the Schedule to the PMLA this imprisonment may extend to a period of up to 10 years.

5. Concluding Remarks

Many do not perceive Money-Laundering as a crime, or at least see it as a victimless crime. However, the consequences of such Money-Laundering on the economy are far reaching and long-lasting. They keep funds out of the purview of government taxation, affect development of the country and distort the picture of the economy. They allow criminals to enjoy the proceeds of their crime without much fear and challenges. It is therefore necessary to understand these ill effects and ensure that there are enough checks in place to curtail these activities. Though the debate can be on, it is important to ponder on how effectively the system can be used for good money being spent for good cause, rather than bad money being spent for good cause.

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Why are we, as a nation so obsessed with foreign things? Is it a legacy of our colonial years? We want foreign television sets. We want foreign shirts. We want foreign technology. Why this obsession with everything imported?

– A. P. J. Abdul Kalam

What difference does it make to the dead, the orphans, and the homeless, whether the mad destruction is wrought under the name of totalitarianism or the holy name of liberty or democracy?

– Mahatma Gandhi

Lokpal Act as applicable to Charitable Trusts

CA N. C. Hegde

Background

1.1 The Lokpal and Lokayuktas Act, 2013 ("the Act") was enacted by the Parliament with effect from 16th January 2014 to provide for the establishment of a body of Lokpal for the Union and Lokayukta for States to inquire into allegations of corruption against certain public functionaries. One may recollect that the Act was passed in response to the agitation against corruption in high places. In common terminology, a *Lokpal would mean* a caretaker of people and would probably be similar to an ombudsman who represents public interest. The whole idea behind the Act is to provide a forum for accountability of those who serve the public i.e., public servants. The *Lokpal* is responsible for investigating corruption charges at the national level and the *Lokayukta* at the state level.

Application of the Act

1.2 The Act applies to public servants in and outside India. For this purpose, the definition of "public servant" covers, *inter alia*, Ministers, Members of Parliaments, Government Officers, etc. Going by the preamble of the Act and the intention, that is clearly understandable. However what came as a surprise and is the main matter of discussion in the following paragraphs is the inclusion of office bearers of certain charitable institutions not controlled or financed by the Government within the ambit of the law by deeming them to be public servants.

Public servant

1.3 Given that the Act is aimed at regulating the conduct of public functionaries or public servants, it is important to understand how the term public servant is defined by the law.

1.4 *Public servant is defined by section 2(1)(o) of the Act to mean a person referred to in clauses (a) to (h) of sub-section (1) of section 14 but does not include a public servant in respect of whom the jurisdiction is exercisable by any court or other authority under the Army Act, 1950, the Air Force Act, 1950, the Navy Act, 1957 and the Coast Guard Act, 1978 or the procedure is applicable to such public servant under those Acts."*

Relevance of section 14 to persons in charge of Public trusts

1.5 Section 14 defines a public servant as a person referred to in clauses a to h of sub-section (1) However the clauses relevant to a charitable trust are clauses (f), (g) and (h).

1.6 Section 14(1)(f) seeks to cover any person who is or has been a Chairperson or Member or Officer or Employee in any Body or Board or Corporation or Authority or Company or Society or Trust or Autonomous Body (by whatever name called) established by an Act of Parliament or Wholly or Partly financed by the Central Government or Controlled by it.

Similarly section 14(1)(g) covers bodies that are financed by the Government and provides that any person who is or has been a Director, Manager, Secretary or other Officer of every other Society or Association of Persons or Trust (whether registered under any law for the time being in force or not), by whatever name called, wholly or partly financed by the Government whose annual income exceeds an amount as prescribed will be covered. The amount so prescribed as annual income is ₹ 1 crore.

Section 14(1)(h) widens the coverage to include persons of an institution which is registered under the FCRA and is in receipt of donations exceeding ₹ 10 lakhs or such higher amount as the Central Government may, by notification, specify.

1.7 Thus in summary and in the context of charitable trusts, the definition of 'Public Servant' covers every Board Member and senior employee of charitable institutions and NGOs wholly or partly financed by the Government, the annual income of which exceeds ₹ one crore as also every Board Member and senior Employee of charitable institutions and NGOs registered under FCRA 2010 which receive funds of ₹ 10 lakhs or more in a year.

Declaration of assets and liabilities by a public servant

2.1 Section 44 of the Act provides for a declaration of the assets and liabilities by a public servant. **The section as originally enacted** required annual returns to filed with the competent authority in the prescribed form before the 31st of July every year in respect of assets held as on 31st March of that year. The Competent Authority to whom the annual return is required to be filed is the respective Ministry which has provided the maximum proportion of the grant or donation during the previous year with copies being sent to other relevant Ministries who have provided funding. In case of foreign contribution received the Competent Authority shall be the Ministry of Home Affairs. Further the annual return is required to be furnished by a public servant till the foreign donation received or funds as provided are utilised.

However, keeping in view the concerns expressed by different categories of public servants in relation to the onerous requirements of the declaration and the fact that this would be made public, the provisions were referred to a Standing Committee of Parliament.

2.2 The Standing Committee examined concerns expressed by public servants in regard to the right of privacy and observed that the public disclosure of assets and liabilities of public servants was not necessary since it might lead to misuse of information by miscreants and criminals and may endanger the safety and security of the public servants and their family members. As a result section 44 of the Act as originally enacted was amended to dilute the rigours of the section of filing returns within a particular time line as well putting the information on the public domain. The amended section now provides for a much more simplified version of the law by stipulating that every public servant shall make declaration of his assets and liabilities in such form and manner as may be prescribed.

Reportedly, the Government is in the process of finalizing a fresh set of rules which will be notified in due course of time to prescribe the form, manner and timelines for filing of the declarations.

Consequences of non-compliance with the requirement to file annual return

3.1 An asset shall be presumed to belong to the public servant and shall be presumed to be assets acquired by corrupt means if he fails to declare his assets or gives misleading information in respect of his assets and

is found to be in possession of assets not disclosed or in respect of which misleading information was furnished. However the presumption will not apply unless such failure is wilful or for reasons which are not justifiable and is rebuttable and will not apply if the servant proves otherwise.

3.2 The competent authority is empowered to condone or exempt a public servant from furnishing information in respect of assets not exceeding a prescribed minimum value [proviso to section 45.

As per a Circular issued,in case where such Public Servant or Director and Officers of NGOs do not make declaration of their assets, it will be treated as an offence and the Lokpal shall have the power to initiate inquiry and even confiscate the assets of such officers.

3.3 In this context it must be noted that Public Servants are liable to inquiry, if a complaint is made against them to the Lokpal. Any member of the public can file such a compliant. If the Lokpal finds evidence of corruption against the public servant, a case would be filed. As an interim measure, Lokpal may also order confiscation of assets acquired through corrupt means.

Issues arising out of the Lokpal Act to public charitable trusts

4.1 As mentioned in the opening paragraphs, the inclusion of office bearers and persons in charge of public charitable trusts that receive foreign contribution as prescribed is something that cannot be clearly comprehended as there is no similar nexus to public funds as public functionaries or public servants. The definitions of manager, secretary and Director are not provided which lead to ambiguity. The other challenge which would arise is lack of clarity in regard to the way the law is to be interpreted ie a literal application of the designations or the functions as performed by the persons employed by the trust.

A breather has been provided by postponing the onerous requirements of declaration and the same being uploaded in the public domain as originally envisaged. However the requirements of the declaration will totally be with the rule makers as the law has empowered them to prescribe a declaration as felt fit.

Law a serious deterrent to individuals

5.1 The inclusion of trustees and other office bearers of public trusts within the ambit of the Lokpal Act is a very far reaching provision. While once can understand the applicability to institutions controlled or financed by the Government, the coverage to institutions that receive foreign contribution of ₹ 10 lakhs could subject such office bearers to intrusive scrutiny of their personal affairs and also brings to public domain the personal information where apparently such information may not have any direct nexus with the functioning of the trust. Most trustees of public trusts have often become part of such trusts as their commitment towards corporate social responsibility and with a view to give back to the society. Further given that India fares poorly on the social equity index there is a dire need for private resources and funding to supplement efforts of the Government to make growth more inclusive. Also persons of Indian origin outside India and endowments/foundations are very keen to give back to the society.

5.2 The requirement to furnish detailed information on personal assets and liabilities would only seek to deter such high net worth individuals to become trustees of trusts and come in the way of charity. On one hand we have had a unique feature of a mandatory CSR for corporates in the Companies Act thereby extending them a hand to participate in social development and on the other hand we make it onerous for them to act as trustees and managers of trusts. A classic case of one hand taking back what the other seeks to give.

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Principles of Mutuality

Mandar Vaidya,
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The doctrine of mutuality, based on common law principles, is premised on the theory that a person cannot make a profit from himself. An amount received from oneself cannot be regarded as income and taxable. The essence of the principle of mutuality lies in the commonality of the contributors and the participants who are also the beneficiaries. The contributors to the common fund must be entitled to participate in the surplus and the participators in the surplus are contributors to the common fund.

The law envisages a complete identity between the contributors and the participants in this sense. The principle postulates that what is returned is contributed by a member. Any surplus in the common fund shall therefore not constitute income but will only be an increase in the common fund meant to meet sudden eventualities. A common feature of mutual organisations in general can be stated to be that the participants usually do not have property rights to their share in the common fund, nor can they sell their share. Cessation from membership would result in the loss of right to participate without receiving a financial benefit from the cessation of the membership.

Section 2(24) of the Income-tax Act defines taxable income. The income of a cooperative society from business is taxable under Section 2(24)(vii) and will stand excluded from the principle of mutuality.

The principle relates to the notion that a person cannot make a profit from himself. An amount received from oneself is not regarded as income and is therefore not subject to tax; only the income which comes within the definition of Section 2(24) of the Act is subject to tax (income from business involving the doctrine of mutuality is denied exemption only in special cases covered under clause (vii) of Section 2 (24) of the Act). The concept of mutuality has been extended to defined groups of people who contribute to a common fund, controlled by the group, for a common benefit. Any amount surplus to that needed to pursue the common purpose is said to be simply an increase of the common fund and as such neither considered income nor taxable. Over time, groups which have been considered to have mutual income have included corporate bodies, clubs, friendly societies, credit unions, automobile associations, insurance companies and finance organizations. *Mutuality is not a form of organization, even if the participants are often called members.* Any organization can have mutual activities. A common feature of mutual organizations in general and of licensed clubs in particular, is that participants usually do not have property rights to their share in the common fund, nor can they sell their share. And when they cease to be members, they lose their right

to participate without receiving a financial benefit from the surrender of their membership. A further feature of licensed clubs is that there are both membership fees and, where prices charged for club services are greater than their cost, additional contributions. It is these kinds of prices and/or additional contributions which constitute mutual income.

The doctrine of mutuality finds its origin in common law. One of the earliest modern judicial statements of the mutuality principle is by Lord Watson in the House of Lords, in 1889, in ***Styles (Surveyor of Taxes) vs. New York Life Insurance Co 14 App CAS 381: (1883-1890) 2 TC 460*** (hereinafter referred to as the "Styles case"). The appellant in that case was an incorporated company. The company issued life policies of two kinds, namely, participating and non-participating. The members of the mutual life insurance company were confined to the holders of the participating policies, and each year, the surplus of receipts over expenses and estimated liabilities was divided among them, either in the form of a reduction of future premiums or of a reversionary addition to the policies. There were no shares or shareholders in the ordinary sense of the term but each and every holder of a participating policy became *ipso facto* a member of the company and as such became entitled to a share in the assets and liable for a share in the losses. The company conducted a calculation of the probable death rate amongst the members and the probable expenses and liabilities; calls in the shape of premiums were made on the members accordingly. An account used to be taken annually and the greater part of the surplus of such premiums, over the expenditure referable to such policies, was returned to the members i.e. (holders of participating policies) and the balance was carried forward as a fund in hand to the credit of the general body of members. The question was whether the surplus returned to the members was liable to be assessed to income tax as profits or gains. The majority of the Law Lords answered the question in the negative. It should be noted that in that case the members had associated themselves together for the purpose of insuring each other's life on the principle of mutual assurance, that is to say, they contributed annually to a common fund out of which payments were to be made, in the event of death, to the representatives of the deceased members. Those persons were alone the owners of the common fund and they alone were entitled to participate in the surplus. This surplus was sourced, partly from the profits arising from non-participating policies and other business. It was held that the portion of the surplus which arose from the excess contributions of the holders of participating policies was not an assessable profit. It was therefore, held to be a case of mutual assurance. The individuals insured and those associated for the purpose of receiving their dividends and meeting other stipulated requisites under the policies were identical. It was held that that identity *was not destroyed by the incorporation of the company*. Lord Watson even went to the point of stating that the company could not be said to be carrying on any business at all. The majority were of the view that what the members received were not profits but their respective shares of the excess amount contributed by themselves. In a later case {***The Commissioners of Inland Revenue vs. The Cornish Mutual Assurance Co. Ltd.***}, Lord Watson's statement was explained by the House of Lords wherein it was held that a mutual concern may be held to carry on a business or trade with its members, though the surplus arising from such trade is not taxable income or profit.

The High Court of Australia first considered the mutuality principle in ***The Bohemians Club vs. The Acting Federal Commissioner of Taxation in [1918] HCA 16; 24 CLR 334 1918***. It was observed that a man is not the source of his own income- A man's income consists of moneys derived from sources outside of himself. The Contributions made by a person for expenditure in his business or otherwise for his own benefit cannot be

regarded as his income ... The contributions are, in substance, advances of capital for a common purpose, which are expected to be exhausted during the year for which they are paid. It was held that the contributions of the collective body of members are comparable to the calls paid by members of a company upon their shares are income of the company. If anything is left unexpended it is not income or profits, but savings, which the members may claim to have returned to them.

The Hon'ble Supreme Court had an occasion to address the issue of mutuality in ***CIT, Bombay City vs. Royal Western India Turf Club Ltd. AIR 1968 SC 425 (SC): 24 ITR 551***. It quoted with approval three criteria stipulated in The English & Scottish Joint Co-operative Wholesale Society Ltd. (supra). It was observed by the Hon'ble Apex Court that the criteria necessary for applying the principle of mutuality are:

(1) the identity of the contributors to the fund and the recipients from the fund;

(2) the treatment of the company, though incorporated, as a mere entity for the convenience of the members and policy holders, in other words, as an instrument obedient to their mandate; and

(3) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves."

The first condition requires that there must be a complete identity between the contributors and participators. This was first laid down by ***Lord Macmillan in Municipal Mutual Insurance Ltd. vs. Hills (1929-1932) 16 TC 430*** wherein it was observed that the cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words, there must be complete identity between Members' clubs are an example of a mutual undertaking; but, where a club extends facilities to non-members, to that extent the element of mutuality is missing. A members' club is assessable, in respect of profits derived from affording its facilities to non-members. In ***Carlisle and Silloth Golf Club vs. Smith, (1913) 3 K.B. 75***, where a members' golf club admitted non-members to play on payment of green fees it was held that it was carrying on a business which could be isolated and defined, and the profit of which was assessable to income tax. But there is no liability in respect of profits made from members who avail themselves of the facilities provided for members.

Therefore, in the case of ***Royal Western India Turf Club Ltd. (supra),*** since the club realized money from both members and non-members, in lieu of the same services rendered in the course of the same business, the exemption of mutuality could not be granted. The Hon'ble Court held:

"……..in the instant case there is no mutual dealing between the members *inter se* and no putting up of a common fund for discharging the common obligations to each other undertaken by the contributors for their mutual benefit. On the contrary, we have here an incorporated company authorised to carry on an ordinary business of a race course company and that of licensed victuallers and refreshment purveyors and in fact carrying on such a business. There is no dispute that the dealings of the company with non-members take place in the ordinary course of business carried on with a view to earning profits as in any other commercial concern."

Simon's Taxes, Vol. B, 3rd Edn., paras B1.218 and B1. 222 (pp. 159 and 167) states the legal position, thus:

"..it is settled law that if the persons carrying on a trade do so in such a way that they and the customers are the same persons, no profits or gains are yielded by the trade for tax purposes and therefore no assessment in respect of the trade can be made. Any surplus resulting from

this form of trading represents only the extent to which the contributions of the participators have proved to be in excess of requirements. Such a surplus is regarded as their own money and returnable to them. In order that this exempting element of mutuality should exist it is essential that the profits should be capable of coming back at some time and in some form to the persons to whom the goods were sold or the services rendered....

In short, there has to be a complete identity between the class of participators and class of contributors; the particular label or form by which the mutual association is known, is of no consequence. Kanga & Palkhivala explains this concept in "The Law and Practice of Income Tax" (8th Edn. Vol. I, 1990) at p. 113 as follows:

"...The contributors to the common fund and the participators in the surplus must be an identical body. That does not mean that each member should contribute to the common fund or that each member should participate in the surplus or get back from the surplus precisely what he has paid." The Madras, Andhra Pradesh and Kerala High Courts have held that the test of mutuality does not require that the contributors to the common fund should willy-nilly distribute the surplus amongst themselves : it is enough if they have a right of disposal over the surplus, and in exercise of that right they may agree that on winding up the surplus will be transferred to a similar association or used for some charitable objects."

The British Tax Encyclopedia (I), 1962 Edn. (edited by G.S.A. Wheatcroft) at pp. 1201, dealing with "mutual trading operations", states the law as under:

"For this doctrine to apply (mutuality), it is essential that all the contributors to the common fund are entitled to participate in the surplus and that all the participators in the surplus are contributors, so that there is complete identity between contributors and participators. This means identity as a class, so that at any given moment of time the persons who are contributing are identical with the persons entitled to participate; it does not matter that the class may be diminished by persons going out of the scheme or increased by others coming in...."

In ***Jones vs. South-West Lancashire Coal Owners' Association Ltd.*** Viscount Cave LC held that "sooner or later, in meal or in malt, the whole of the associations" receipts must go back to the policy holders as a class, though not precisely in the proportions in which they have contributed to them and the association does not in any true sense make any profit out of their contributions.

The second feature demands that the actions of the participators and contributors must be in furtherance of the mandate of the association. In the case of a club, it would be necessary to show that steps are taken in furtherance of activities that benefit the club, and in turn its members. Therefore, in ***Chelmsford Club vs. CIT***, since the appellant provided recreational facilities exclusively to its members and their guests on "no-profit-no-loss" basis and surplus, if any, was used solely for maintenance and development of the club, the Court allowed the exception of mutuality.

Therefore, as Finlay J. observed in ***National Association of Local Government Officers vs. Watkins (1931-1934) 18 TC 499***, where member of a club orders dinner and consumes it, there is no sale to him. At the same time, as in case of ***CIT, Bihar vs. Bankipur Club Ltd.,*** where a club makes 'surplus receipts' from the subscriptions and charges for the various conveniences paid by members, even though there is no direct benefit of the receipts to the customers, the fact that they will eventually be used in furtherance of the services of the club must be considered as a furtherance of the mandate of the club.

Finally, there must be no scope of profiteering by the contributors from a fund made by them which could only be expended or returned to themselves. The settled legal position comes from Rowlatt, J's observations in ***Thomas vs. Richard Evans & Co. Ltd.*** wherein, it was held

that if profits are distributed to shareholders as shareholders, the principle of mutuality is not satisfied. He observed thus:

"But a company can make a profit out of its members as customers, although its range of customers is limited to its shareholders. If a railway company makes a profit by carrying its shareholders, or if a trading company, by trading with the shareholders - even if it limited to trading with them - makes a profit, that profit belongs to the shareholders, in a sense, but it belongs to them qua shareholders. It does not come back to them as purchasers or customers. It comes back to them as shareholders, upon their shares. Where all that a company does is to collect money from a certain number of people - it does not matter whether they are called members of the company, or participating policy holders - and apply it for the benefit of those same people, not as shareholders in the company, but as the people who subscribed it, then, as I understand the New York case, there is no profit. If the people were to do the thing for themselves, there would be no profit, and the fact that they incorporate a legal entity to do it for them makes no difference, there is still no profit. This is not because the entity of the company is to be disregarded, it is because there is no profit, the money being simply collected from those people and handed back to them, not in the character of shareholders, but in the character of those who have paid it. …..."

In ***CIT, Madras vs. Kumbakonam Mutual Benefit Fund Ltd.,*** the Hon'ble Apex Court denied the exemption of mutuality because of the taint of commerciality. It was observed thus:

"It seems to us that it is difficult to hold that Style's case applies to the facts of the case. A shareholder in the assessee company is entitled to participate in the profits without contributing to the funds of the company by taking loans. He is entitled to receive his dividend as long as he holds a share. He has not to fulfil any other condition. His position is in no way different from a shareholder in a banking company, limited by shares. Indeed, the position of the assessee is no different from an ordinary bank except that it lends money to and receives deposits from its shareholders. This does not by itself make its income any the less income from business within S. 10 of the Indian Income-tax Act."

However, at what point mutuality ends and commerciality begins is a difficult question of fact. It is best summarized in ***Bankipur Club 226 ITR 97 (SC)***, wherein the Hon'ble Apex Court observed:

"…if the object of the assessee company claiming to be a "mutual concern" or "club", is to carry on a particular business and money is realised both from the members and from non-members, for the same consideration by giving the same or similar facilities to all alike in respect of the one and the same business carried on by it, the dealings as a whole disclose the same profit earning motive and are alike tainted with commerciality. In other words, the activity carried on by the assessee in such cases, claiming to be a "mutual concern" or "members' club" is a trade or an adventure in the nature of trade and the transactions entered into with the members or non-members alike is a trade/business/ transaction and the resultant surplus is certainly profit - income liable to tax. We should also state, that "at what point, does the relationship of mutuality end and that of trading begin" is a difficult and vexed question. A host of factors may have to be considered to arrive at a conclusion. "Whether or not the persons dealing with each other, is a 'mutual club' or carrying on a trading activity or an adventure in the nature of trade", is largely a question of fact [Wilcock's case - 9 Tax Cases 111, (p.132); C.A. (1925) (1) KB 30 at p. 44 and 45]."

In ***Royal Western India Turf Club Ltd. (supra),*** the Apex Court made similar observations, holding that it is not always the case that a legal entity cannot make profits out of its members. It held as follows :

"14…The principle that no one can make a profit out of himself is true enough but may in its application easily lead to confusion. There is nothing 'per se' to prevent a company from making a profit out of its own members. Thus a railway company which earns profits by carrying passengers may also make a profit by carrying its

shareholders or a trading company may make a profit out of its trading with its members besides the profit it makes from the general public which deals with it but that profit belongs to the members as shareholders and does not come back to them as persons who had contributed them.

Where a company collects money from its members and applies it for their benefit not as shareholders but as persons who put up the fund the company makes no profit. In such cases where there is identity in the character of those who contribute and of those who participate in the surplus, the fact of incorporation may be immaterial and the incorporated company may well be regarded as a mere instrument, a convenient agent for carrying out what the members might more laboriously do for themselves. But it cannot be said that incorporation which brings into being a legal entity separate from its constituent members is to be disregarded always and that the legal entity can never make a profit out of its own members…"

In ***Kumbakonam Mutual Benefit Fund Ltd. case 53 ITR 241 (SC),*** the facts were that the assessee, i.e. the Kumbakonam Mutual Benefit Fund Ltd., was an incorporated company limited by shares. Since 1938, the nominal capital of the assessee was ₹ 33,00,000/- divided into shares of ₹ 1/- each. It carried on banking business restricted to its shareholders, i.e., the shareholders were entitled to participate in its various recurring deposit schemes or obtain loans on security. Recurring deposits were obtained from members for fixed amounts to be contributed monthly by them for a fixed number of months as stipulated at the end of which a fixed amount was returned to them according to published tables. The amount so returned, covered the compound interest of the period. These recurring deposits constituted the main source of funds of the assessee for advancing loans. Such loans were restricted only to members who had, however, to offer substantial security therefor, by way of either the paid up value of their recurring deposits, if any, or immovable properties within a particular district. Out of the interest realised by the assessee on the loans which constituted its main income, interest on the recurring deposits aforesaid was paid as also all the other outgoings and expenses of management and the balance amount was divided among the members pro rata according to their share-holdings after making provision for reserves, etc., as required by the Memorandum or Articles aforesaid. It was not necessary for the shareholders, who were entitled to participate in the profits to either take loans or make recurring deposits.

On these facts, the Court distinguished Styles case (supra) and opined that the position of the assessee was no different from an ordinary bank except that it lent money and received deposits from its shareholders. This did not by itself make its income any less income from business. In our opinion, the ratio of the said decision is on all fours to the facts at hand. The interest earned by the assessee even from the member banks on the surplus funds deposited with them had the taint of commerciality, fatal to the principle of mutuality.

In ***Bangalore Club vs. CIT (2013) 29 taxmann.com 29: 350 ITR 509 (SC)***, the Hon'ble Supreme Court on the facts of that case found the club from time to time was depositing surplus income in the form of fixed deposits of member banks, as an investment to earn higher return. The club had claimed interest earned on fixed deposits kept with certain banks which were corporate members of the assessee and claim exemption on the basis of doctrine of mutuality on the interest earned on fixed deposits kept with non-member banks which were offered to tax. On these facts, the Hon'ble Supreme Court had held that the condition of claim of mutuality is not satisfied.

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Important Case Laws (Subject-Wise) & Important Circulars on Charitable Trusts

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Introduction

The Income-tax Act, 1961 aims to collect revenue from different categories of person as their contribution towards development of this nation. However, considering the philanthropic purposes underlying the establishment and functioning of charitable institutions, our statute has extended plethora of benefits in the form of exemption from Income-tax to such Institutions. Since, even the greatest physicist Albert Einstein had said "If there is something in this world that is difficult to understand, it is Income Tax", the provisions relating to Income Tax in case of trusts are no exception i.e. those are subject to lot of controversies and interpretational differences. Hence, an attempt has been made to compile the conclusions from important decisions and circulars/notifications in relation to Charitable Institutions. Hope you find it a worthwhile read.

PART A – CASE LAWS

I. General - Charity and Charitable Purpose [Section 2(15)]

1. **Charitable & Religious Objects**
   CIT vs. Dawoodi Bohara Jamat (2014) 364 ITR 31 (SC)

   In this case it was held that where the assessee trust is formed with both religious and charitable objects, in terms of section 13(1)(b), its claim for registration under section 12AA can be denied only in a case when such objects are carried out for benefit of a particular religious community or caste.

2. **Effect of insertion of proviso to Sec. 2(15)**
   The Institute of Chartered Accountants of India vs. Director General of IT (Exemption) (2013) 358 ITR 91 (Delhi HC)

   The main objective of ICAI is regulating profession of Chartered Accountancy in India by providing or imparting education in the field of accountancy. Conducting coaching classes falls within the ambit of education. Therefore, it was held by the Delhi HC that such activities fall within the definition of education and proviso to Section 2(15) is not attracted.

3. **Effect of insertion of proviso to Sec. 2(15) on Registration**
   Mahatma Gandhi Charitable Society vs. CIT (2013) 142 ITD 565 Cochin Tribunal

   The Tribunal held that the cancellation of registration

can take place only under the circumstances as envisaged in Section 12AA(3) i.e., when the activity of the trust are not genuine or are not being carried out in accordance with the objects of the trust or exemption will not be available where the limit as provided in proviso is crossed. The Tribunal is of the considered opinion that the subsequent amendment to section 2(15) of the Act by introducing proviso fixing the monetary limit in respect of Public Utility Services cannot be a reason to cancel the registration. (This was also held in the case of ***Tamil Nadu Cricket Association vs. DIT Exemption (2014) 360 ITR 633 Madras HC).***

4. Effect of insertion of proviso to Sec. 2(15)
Object to promote Leather Trade - ITO Kolkata vs. Indian Leather Products Association (2016) 156 ITD 392 (Kolkata Tribunal)

In this case, the object of the assessee was to promote leather trade. Rent was received from non-members for keeping their stalls which was negligible in comparison to the total trade receipts. In such circumstances it could not be said to be covered under proviso to Sec. 2(15).

5. Object – Education
Saurashtra Education Foundation vs. CIT (2005) 273 ITR 139 (Gujarat HC)

Mere printing and Publication of books in India does not amount to spending money for the purpose of education. However, first proviso to Section 2(15) cannot be a ground to cancel the Registration granted under Section 12A/12AA.

6. Charitable & Non-Charitable Objects
Yogiraj Charity Trust vs CIT (1976) 103 ITR 777 (SC)

If the trust deed gives discretion to the trustees to spend the income from the trust either for charitable purposes or for non-charitable purposes then such a trust would not fall under Sec. 11 of the IT Act, 1961.

II. Registration & Procedure for Registration - Sec. 12A/12AA

7. Conditions for opting Registration u/s 12A/12AA
Shree Anjaneya Medical Trust vs. CIT Kozhikode (2016) 67 Taxmann.com 230 (Kerala HC)

The Court held that while granting registration to a trust, authorities are empowered to examine only the genuineness of trust. Activities of the trust are to be examined at the time of assessment only. Eligibility in terms of Sec. 11 & 12 is to be verified as to whether or not what was professed was indeed in the Deed of Trust. Further CIT cannot refuse registration on the grounds that the assessee trust had not applied 25% (now it is 15%) of the income for charitable purpose as held in the case of ***Tara Ripu Dampal Trust vs. CIT (2016) Tax Pub (DT) 795 (Chd Tribunal).***

8. Deeming of Registration
CIT Kanpur vs. Society for Promotion of Education, Allahabad (2016) 67 Taxmann.com 264 (SC)

In this case, it has been held that if there is a failure to pass an order in respect of registration within the time frame specified under Section 12AA(2), then registration will be deemed to have been granted under the law.

9. Correlation between Sections 11, 12 and 12A
U.P. Forest Corporation vs. Dy. CIT (2008) 297 ITR 1 (SC)

A Conjoint reading of Sections 11, 12 and 12A makes it clear that registration under Section 12A is a condition precedent for availing benefit under Sections 11 & 12 of the Act.

10. Amendment to Trust Deed
DIT (E) vs. Ramoji Foundation (2014) 364 ITR 85 (A.P. HC)

When the power had been given to the trustees by the settler, trust deed can be amended without approaching the Civil Court provided all the conditions laid down by the settler are fulfilled. The approach of the Civil Court is required where there is no such power. Amended trust deed can be relied upon for purpose of registration.

III. Cancellation of Registration

11. Misappropriation of funds
CIT vs. Islamic Academy of Education (2015) 62 taxmann.com 218 (SC)/(2015) 54 taxmann.com 255

SLP granted against High Court's ruling that where assessee- trust was fulfilling its main object of imparting education, registration of trust could not be cancelled only on basis that trustees were misappropriating funds of said trust.

12. Non-filing of Return cannot lead to cancellation of Registration u/s. 12AA
Shine Educational and Social Welfare Trust vs. CIT (2015) 38 ITR (Tribunal) 634 (Chennai Tribunal)

Assessee trust had not filed return of income from the grant of registration till date. A notice was sent to the trust to state the reasons for non-filing of returns and submitting income expenditure a/c and receipts and payments a/c wherein it was also mentioned that non-compliance would lead to cancellation of registration. This notice remained unserved and hence it was inferred that the trust is not in existence and hence CIT cancelled the registration. Non-filing of a return does not find a mention as a cause for cancellation of section 12AA registration and hence order of CIT was reversed.

13. Charitable Purposes – Exclusion of advancement of any other objects of General Public Utility
DIT (Exemption) vs. Shree Nashik Panchvati Panjrapole (2017) 397 ITR (Bombay HC) 501

If the trust was involved in carrying out activities in nature of trade, commerce or business with receipts in excess of ₹ 10 lakh and the dominant function of assessee was to provide asylum to old sick and stray cows, then selling milk is incidental to its primary activity. Hence, the assessee was not hit by proviso to section 2(15) and there was no need to cancel registration of assessee u/s. 12AA.

14. Cancellation of registration - Section 2(15) & 12AA(3)
DIT vs. Sri Kutherthar Garajachar Charities (2015) 231 Taxman 848 (Karnataka HC)

DIT(E) cancelled registration of assessee holding that dominant activity of assessee was letting out choultry on daily rental basis which was in nature of business. Tribunal allowed the registration. Dismissing the appeal the court held that even if the receipts from Commercial activities

were more when compared to overall receipts from Charitable activities it could neither lead to conclusion that activities of trust were not genuine nor could it be said that activities of the trust were not carried out in accordance with objects of trust and thus cancellation of registration was unjustified (AY 2010-11). SLP is granted to the revenue (2015) 235 Taxman 517 (SC)

15. Proviso to S. 2(15)
The Technological Institute of Textiles and Science vs. DIT (2016) 158 ITD 808 (Kolkata- Tribunal)

The DIT(E) held that the assessee was doing business as well as was engaged in educational activity and, therefore, it was hit by proviso to section 2(15). In view of activities of the assessee, the registration granted to it under section 12AA was withdrawn. On appeal, the assessee contended that it was not hit by the amendment as brought in the statute under section 2(15) because, the only activity of the institution/society had been to run an educational institution and to impart education and textile mill was maintained only to give practical training to students. Registration cannot be cancelled when proviso to Section 2 (15) applies.

16. Breach by Trust
Director of Income Tax vs. Bharat Diamond Bourse (2003) 259 ITR 280 (SC)

In the case there was violation of Section 13 of the I.T. Act, 1961 i.e., trust lent money to one of the founders without adequate security and interest, it was held that the exemption under Sec. 11 will not be available.

17. Rectification or Amendment of Trust Deed
CIT vs. Palghat Shadi Mahal Trust (2002) 254 ITR 212 (SC)

Trust created for the purpose of establishing institutions for the educational, social and economic advancement of the Muslims and for religious and charitable objects recognised by Muslim law providing benefit to Muslims from all over the world, none of whom, except in Kerela, are of backward classes. The trust attracted provisions of Sec. 13(1)(b) and exemption u/s. 11 was not saved by *Explanation* 2 to Section 13.

The rectification or Amendment to trust Deed should be made to bring the true intention. The object of such exercise should not be contrary to the intention of the author of the trust.

IV. Income and Application of Income (Secs. 11 & 12)

18. Accumulation of income
CIT vs. Rao Bahadur Calavala Cunnan Chetty Charities (1982) 135 ITR 485 (Madras)

Section 11 contemplates on application of income from charitable purposes and on accumulation of 25% (now 15%) of the income. So, for that purpose i.e. the application as well as accumulation, income arrived in commercial manner be considered as a base without reference to Section 14.

(Similarly in case of ***CIT vs. Programme of Community Organisation (2001) 248 ITR 1 (SC)),*** it was held that accumulation of income as contemplated u/s 11(1)(a) is Gross Income as per books of account of the Charitable Trust and not as per Total Income as per Income-tax Act, 1961.)

19. Deposit in current account covered u/s. 11(5)
ADIT (E) vs. Murugappa Chettiar Trust (2008) 303 ITR 360 (Madras)

Words 'any account' in section 11(5)(iii) include current account also and hence, deposit made in the current account with a scheduled Bank of India will come within the meaning of the words "deposit in any account with a scheduled bank". It is a classified investment, as contemplated under the provisions of the Act and the same is covered by section 11(5)(iii).

20. Fixed Deposit in bank held as Investment under Sec. 11(5)
DIT(E) and Others vs. D.L.F Qutab Enclave Complex Medical Charitable Trust (2001) 248 ITR 41 (Del)

Assessee, a charitable trust, invested the premium received by it on lease of plot in a Time deposit with the bank. Time Deposit is a capital asset and CIT(A) and ITAT were justified in holding that there was no breach of either Section 11(5) or Section 11(1A) and therefore the assessee was entitled to benefit of Section 11.

21. Consequences of violation of Section 11(5)
CIT vs. Fr. Mullers Charitable Institution (2014) 363 ITR 230 Kerala H.C

In this case, it was held that if there is a violation of Section 11(5), the exemption will not be available to the extent of income derived from such investments. SLP against this judgment is dismissed by the Supreme Court (2014) 227 Taxman 369 (SC).

22. Exemption u/s. 11 - Applicability of proviso to Sec. 2(15) and Sec. 11(4)
AVM Charities vs. ITO (Exemptions) (2019) 174 DTR (Chennai Tribunal) 1

Assessee enjoying registration under Sec.12A with main objects of medical relief and education was eligible for exemption under Sec 11(1). Further, renting of Kalyan Mandapam could only be construed as incidental to attainment of its main object and hence eligible for benefit of section 11(4). Disqualification under first proviso to S.2(15) and S.11 (4A) did not apply.

23. ***Gujarat State Board of School Textbooks vs. ACIT [2016] 75 taxmann.com 281 (Gujarat HC)***

Trust promoting education even if it was engaged in Publication of school books would amount to incidental business and benefit of Sec.11 will be available.

24. Separate books of account
DIT vs. Shri Vile Parle Kelvani Mandal (2015) 235 Taxman 519 (Supreme Court)

The assessee was a trust and had set up various school and colleges. It had shown certain amount of income under the head Management Development Programme and Consultancy charges in case of one university. The High Court had allowed the exemption on the ground that the separate books of account could not be insisted because once these programmes were part and parcel of the activities undertaken and carried out by the Institute of Management Studies then condition set out in Sec 11(4A) was completely satisfied.

V. Voluntary Donations *vis-a-vis* Corpus Donations

25. Membership fee/Subscription fee
Trustees of Shri Kot Hindu Stree Mandal vs. CIT (1994) 209 ITR 396 (Bombay)

The amount of subscription paid by a member to the society can never be considered as gratuitous payment made by

the member to the society or as payment without any consideration. Therefore, the membership and subscription amounts received by the applicant trust/society from its members could not be characterised as 'voluntary contribution' within meaning of the said expression under section 12. Therefore, the subscription amount was not liable to the included in the income of the assessee-trust.

26. Grant Received
CIT vs. Gem and Jewellery Export Promotion Council (1983) 143 ITR 579 (Bombay HC)

Grant-in-aid received by a charitable trust from Government is voluntary contribution entitled to exemption u/s. 11/12 of IT Act 1961.

27. Applicability of Sec. 11(4A) *vis-a-vis* business held in trust
DIT (E) vs. Willington Charitable Trust (2011) 330 ITR 24 (Madras HC)

When a business income is used towards the achievement of the object of the trust it would activity incidental to the achievement of the object of the trust notwithstanding the profit and gain involved therein. Section 11(4A) does not include Section 11(4). Exemption under Sec. 11(4A) would be available only when the business is incidental to the attainment of object of the trust. Therefore, Sec. 11(4) and 11(4A) will have to be read together. Further by holding that Sec. 11(4A) would override Sec. 11(4) would make the very provision contained in Sec. 11(4) otiose and redundant. Factual question is whether actual income is wholly and exclusively applied to the object of the trust. In other words, if the AO finds that the income as shown in the return is not actually utilised for charitable purpose as claimed by the assessee then the exemption claimed for the said income is not available.

28. Corpus donations *vis-a-vis* trust not registered under Sec. 12A.
Bank of India Retired Employees Medical Assistance Trust vs. ITO (Exemption) (2018) 172 DTR (Mumbai Tribunal) 140).

Since the assessee trust is not registered under Se.12A, it is disentitled from taking recourse to Sec 11(1)(d). However amount received by the assessee trust towards corpus fund is in the nature of capital receipt and therefore the same cannot be brought to tax as income under Se.2 (24) (iia) (A.Y. 2012-13).

29. Exemption of income from property held under Corpus donation
CIT (Exemption) Kochi vs. Mata Amrithanandamayi Math Amritapuri (2018) 94 taxmann.com 82 (SC)

Where assessee received corpus donation on which it earned interest, in view of specific direction of donors that said interest would also form part of corpus, assessee's claim for exemption under section 11 in respect of interest so earned was to be allowed.

30. Project Grants or Grants in aid is Corpus Donation?
Director of Income Tax vs. Ramkrishna Seva Ashrama (2013) 258 CTR (Karnataka HC) 201

The assessee trust was receiving specific donations for Rural Project Fund shown under Rural Project Fund Account. The Court held that the amount received for specific project and held under a specific head amounts to Corpus donation i.e. Capital Receipt.

31. Receipt of Grants for Specific Purpose
DIT (E) vs. Society for Development Alternatives (2012) 205 Taxman 373

Where assessee carrying on charitable work received grants for specific purposes from certain agencies, the appellant acts as a custodian of the funds given by the funding agency to channelise the same in particular direction and these grants could not be considered voluntary contribution as per Section 12 of IT Act, 1961.

VI. Accumulation of Income & Depreciation

32. Specification of objects of trust in case of Accumulation (Form no. 10)
Bharath Kalyan Pratisthan vs. Director of IT (E) (2008) 299 ITR 406 (Del HC)

Normally, the object for which accumulation is sought is to be mentioned in Form No 10. The trust deed required the trust to utilize its funds for charitable purposes, which were medical relief, education and relief to the poor. In the application seeking exemption, the assessee had specified those three objects. It was not required for the assessee to be more specific with regard to the utilization of the fund. The Decision in the case of ***DIT (E) vs. Daulat Ram Education Society (2005) 268 ITR 260 Del*** was followed.

(A similar view was held in ***Paradip Port Trust vs. ACIT (2011) 141 TTJ (Ctk Tribunal) 218; DIT vs. Mitsui & Co Environment Trust (2008) 303 ITR 111 (Del)*** and ***CIT vs. Industrial Extension Bureau (2014) 367 ITR 270 (Gujarat HC)***)

33. Revised Form 10
CIT vs. Simla Diocese Society (2009) 318 ITR 96 (Punjab & Haryana HC)

In this case, modified Form No. 10 filed before conclusion of the assessment was considered valid in view of Supreme Court's decision in case of ***Nagpur Hotel Owners' Association [2001] 247 ITR 201(SC).***

34. Computation of Income (Claim of depreciation)
CIT vs. Rajasthan and Gujarati Charitable Foundation (2018) 402 ITR 441 (SC)

Depreciation on assets was allowed as application of income to charitable purposes (position prior to 1-4-2015). The amendment in Section 11(6) of the Act brought by the Finance (No. 2) Act 2014 which became effective from the A.Y. 2015-16 and prohibited the allowance of depreciation in such cases is prospective in nature. Once the assessee is allowed depreciation it shall be entitled to carry forward the depreciation as well.

35. Application of Income: Excess Expenditure incurred in Earlier year
CIT (Exemption) vs. Sabros Education Society (2018) 166 DTR (SC) 257

Any excess expenditure incurred by the charitable institution in earlier assessment year could be allowed to be set off against income of subsequent years by invoking Sec. 11.

VII. Forfeiture of Exemptions

36. Failure to invest in a mode specified (Shares held in Cooperative Bank for availing loan)
Dr. Vikhe Patil Foundation vs. ITO (2013) 155 TTJ 176 (Mumbai Tribunal)

Where shares of co-operative bank were purchased by the trust registered under Sec.12A to avail loan from them for

furtherance of objects of the trust, the question arose whether there is a violation under Section 13(1)(d) r.w.s 11(5)? Whether exemption can be denied? The Court held that for the purposes of availing loan from bank, holding shares of such bank was a prerequisite and hence it was not considered as violation to deny exemption.

37. Temporary loan
Director of IT vs. Acme Education Society (2010) 326 ITR 146 (Del)

Temporary loan to a society or a Charitable Institution would not amount to an investment or deposit. Therefore, Sec. 13(1)(d) read with Sec.11(5) will not apply as held in the case of.

38. Shares received as gift or corpus Donation is not attracted by Section 13(1)(c)(ii)
CIT vs. Birla Charity Trust (1988) 170 ITR 150 (Cal)

There is no investment within the meaning of Section 13(2)(h) where the assessee trust received by way of donation shares in a company in which settlers had substantial interest, moreso when the donation was prior to 1-6-1970. It was held that as the assessee had received the shares by way of donation, the provisions of Sec. 13(2)(h) read with 13(1)(c) had no application and that the dividend received by the assessee from the said shares was exempt from Income-tax.

39. Vehicle in the name of the Trustee
Audyogik Shiskha Mandal vs. ITO (2018) 103 CCH 386

Where the funds of the assessee trust were utilized for purchase of car in the name of its trustee, there is violation under Sec. 13 (2)(b) read with Sec. 13(3) and the denial of exemption u/s. 11 should be restricted to the amount which was diverted i.e. benefit of Section 11 would not be available only in respect of diverted income.

PART B – Notifications, Circulars, Instructions and Guidelines Issued by the CBDT

1. Circular No. 10/2019 dated 22-5-2019
Subject – Condonation of delay in filing of Form 10B for the years prior to A.Y. 2018-19

The delay in filing of Form No. 10B for A.Y. 2016-17 and A.Y. 2017-18 in all such cases where the Audit Report for the previous year has been obtained before the filing of Return of Income and has been furnished subsequent to the filing of the Return of Income but before the date specified under Section 139 of the Act is condoned. (Para 4(1) of the circular)

2. Ref F. No. 173/193/2019/ITA dated 23-5-2019
Subject – Clarification regarding the time allowed for filing of Return of Income subsequent to the insertion of Section 12A(1)(ba) of the IT Act, 1961

Trust registered under Section 12AA of the Act which avail the benefit of exemption u/s. 11 shall *inter alia* file its Return of Income within the time allowed under Section 139 of the Act from AY 2018-19 onwards. Accordingly, order u/s 143 (1)(a) in cases in which demand was raised on this issue had to be rectified.

3. Circular No. 26/2019 dated 26-9-2019
Subject – Clarification in respect of filing up of return forms for the A.Y. 2019-20 (Ref-F. No. 370142/1/2019-TPL(Pt.-1))

Question 8: I am a trust registered under section 12A/12AA filing return of

income in ITR-7. The amount received as corpus donation should be treated as exempt. However the departmental utility is including this amount as part of total income?

Answer: In Part A – General in the table "Details of registration or approval under the Income-tax Act", please enter 'section 12A/12AA' under the column "section under which registered or approved". Further, in the column on filing status, please choose "section 11" in the drop-down provided against the field "please specify the section under which the exemption is claimed". If these details are furnished correctly in Part A-General, the amount of corpus donation would not be included in total income.

4. **CBDT Circular No. 2/2018 dated 15-2-2018**
Subject – Explanatory Notes to the provisions of the Finance Act 2017 (F. No 370142/15/2017 TPL)

This circular effective from AY 2018-19 onwards provides clarity in procedure in respect of change or modifications of object and filing of return of income in case of entities exempt under Sections 11 & 12 (Para No. 15 of the Circular) and also provides for transparency in electoral funding.

5. **Circular No. 7/2018 dated 20-12-2018**
Sub-Condonation of delay under Section 119(2)(b) of the Income-tax Act, 1961 in filing of Form No. 10 and Form No. 9A for the AY 2016-17. (F No. 197/55/2018-ITA-I)

The Commissioner will, while entertaining such belated application in Form No. 9A and Form 10 satisfy themselves that the amount accumulated or set apart has been invested or deposited in any one or more of the forms or modes specified in sub-section (5) of Section 11 of the Act. (Para 6).

6. **Circular No. 21/2016 dated 27-5-2016**
Subject – Clarification regarding cancellation of registration u/s. 12AA of the IT Act, 1961 in certain circumstances. (F No 197/17/2016/ ITA 1)

As per Para 4, "In view of the aforesaid position, it is clarified that it shall not be mandatory to cancel the registration already granted u/s. 12AA to a Charitable Institution merely on the ground that the cut off specified in the proviso to Section 2(15) of the Act is exceeded in a particular year without there being any change in the nature of activities of the institutions. If in any particular years, the specified cut-off is exceeded, the tax exemption would be denied to the institution in that year and cancellation of registration would not be mandatory unless such cancellation becomes necessary on the grounds prescribed under the Act."

7. **Circular No. 2 of 2012 dated 22-5-2012 Ref-(F. No 142/01/2012 (TPL))**
Definition of Charitable purpose is explained in relation to the advancement of any other object of general public utility.

8. **Circular No. 5 of 2010 dated 3-6-2010**
Subject -Inclusive definition of Charitable Purpose (F. No. 142/13/2010 SO (TPL))

Amendment was made to include certain activities within the ambit of provisions relating to "Charitable Purpose" in the Income-tax Act, 1961.

9. **Circular No. 1 of 2007 dated 27-4-2007**
Subject – Raising of threshold limit of Audit of Accounts by a Charitable or Religious Trust or Institution.

The audit of accounts of a charitable trust is required in case in which total income of trust as computed under IT Act 1961, without giving effect to the provisions of sections 11 & 12 exceeds maximum amount which is not chargeable to tax.

10. **Circular No. 11/2008 dated 19-12-2008**
In this circular, inclusion of the advancement of any other object of general public utility in Section 2(15) is explained in detail.

11. **Circular No. 621 dated 19-12-1991**
Subject– Section 13(1)(d) - Forfeiture of exemption from Tax

Exemption from tax to a charitable or religious trust or institution will be forfeited if any funds of the trust or institution are invested or deposited after 28-2-1983, otherwise than in any one or more of the forms or modes mentioned in section 11(5) of the Income-tax Act, 1961.

12. **Circular No. 596 dated 15-3-1991**
Investment of Trust Funds: Clarification regarding applicability of section 13(1)(d) from A.Y. 1983-84.

13. **CBDT Instruction No. 883 dated 24-9-1975**
Subject – Application of Income -Capital Gains

Investment in Fixed Deposits in the bank for 6 months or more would be regarded as utilisation of the amount of net consideration for acquiring ‘another capital asset' within the meaning of Section 11(1A) of the IT Act, 1961.

14. **Circular No. 100 dated 24-1-1973**
Subject – Repayment of debt incurred for the purpose of business (F. No. 195/1/72-IT(A1)

The Board has decided that repayment of the loan originally taken to fulfil one of the objects of the trust will amount to an application of the income for charitable and religious purposes. (Para 2)

15. **Circular No. 72 dated 6-1-1972**
Effect of amendment in Sec. 13(4) by Finance (No. 2) Act, 1971 in respect of investment of funds in an interested person’s concern is explained in the circular.

16. **Circular No. 335 dated 13-4-1982 (Clarification)**
Investment of trust funds, conditions prescribed under Section 11(1)(a) and Section 13(1)(d) required to be fulfilled to claim exemption under section 11.

17. **Circular No. 45 of 1970 dated 2-9-1970 (Explanation FA 1970)**
Subject – Transaction which would be considered as use of trust income or property for the benefit of the specified persons

New sub-section (2) of Sec. 13 sets forth certain categories of transaction which would be considered as tantamount to the use or application of the trust income or property for the benefit of specified persons. These transactions specified in clauses (a) to (h) of sub section (2).

Conclusion

An attempt has been made to discuss various issues in a lucid manner. Practical approach to the issues is a core requirement to deal with complex issues faced by various Charitable Institutions.

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DIRECT TAXES

Supreme Court

Keshav B. Bhujle,
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1 ***S. C. Naregal vs. CIT***
[2019] 418 ITR 455 (SC): dated 23-10-2019

Appeal to High Court – Monetary limit – appeals by Department – CBDT Instruction on monetary limit applicable to all appeals – Applicable to pending appeals – High Court not justified in deciding appeal (A.Ys. 1991-92 to 2001-02)

In an appeal filed by the Department against the decision of the Tribunal, the assessee pointed out that the tax effect in the case is less than the amount fixed by the CBDT and contended that the appeal by the Department deserves to be dismissed. The High Court held that where a substantial question of law is involved, the mere fact that the monetary limit had been prescribed for filing appeals by the Department would not be a bar to deciding the appeal, and that even otherwise, this was an exceptional case where the Department was justified in filing the appeal, and proceeded to decide the appeal on the merits, answering the question of law in favour of the Department.

The Supreme Court allowed the appeal filed by the assessee and held as under:

"i) The CBDT Instruction No. 5 of 2008 dated 15/05/2008 would apply even to pending matters but subject to the two caveats provided in *CIT vs. Surya Herbal Ltd. (2013) 350 ITR 300(SC)* (i.e., when the matter had a cascading effect, or where a common principle may be involved in a subsequent group of matters or a large number of matters).

ii) In the present case, there was no possibility of a cascading effect nor was the issue involved in a group of matters, as such.

iii) The judgment of the High Court was to be set aside and the Department's appeal before the High Court treated as dismissed because of low tax effect, leaving the question of law open."

2 ***Rojer Mathew vs. South Indian Bank***
[2019] 111 taxmann.com 208 (SC): dated 13-11-2019

Finance Act, 2017 – Tribunal, Appellate Tribunal and other Authorities (Qualifications, Experience and other Conditions of Service of Members) Rules,

2017 suffer from various infirmities; these Rules formulated by Central Government u/s. 184 of Finance Act, 2017 being contrary to parent enactment and principles envisaged in Constitution as interpreted by this Court, are struck down in entirety

The Constitutional validity of Part XIV of the Finance Act, 2017 and the consequential Rules relating to Appellate Tribunal and other authorities were challenged in this case. The Supreme Court has quashed the same. The Supreme Court held and directed as under:

i) Tribunal, Appellate Tribunal and other Authorities (Qualifications, Experience and other Conditions of Service of Members) Rules, 2017 suffer from various infirmities; these Rules formulated by Central Government under Section 184 of Finance Act, 2017 being contrary to parent enactment and principles envisaged in Constitution as interpreted by this Court, are struck down in entirety

ii) Central Government is accordingly directed to reformulate Rules strictly in conformity and in accordance with principles delineated by this Court in various cases.

iii) New set of Rules to be formulated by Central Government shall ensure non-discriminatory and uniform conditions of service, including assured tenure, keeping in mind fact that Chairperson and Members appointed after retirement and those who are appointed from Bar or from other specialised professions/services, constitute two separate and distinct homogeneous classes.

iv) It would be open to Central Government to provide in new set of Rules that Presiding Officers or Members of Statutory Tribunals shall not hold 'rank' and 'status' equivalent to that of Judges of Supreme Court or High Courts, as case may be, only on basis of drawing equal salary or other perquisites.

v) There is a need-based requirement to conduct 'Judicial Impact Assessment' of all Tribunals referable to Finance Act, 2017 so as to analyse ramifications of changes in framework of Tribunals as provided under Finance Act, 2017. Thus, we find it appropriate to issue a writ of mandamus to Ministry of Law and Justice to carry out such 'Judicial Impact Assessment' and submit result of findings before competent legislative authority.

vi) Central Government in consultation with Law Commission of India or any other expert body shall revisit provisions of statutes referable to Finance Act, 2017 or other Acts as listed in this order and place appropriate proposals before Parliament for consideration of need to remove direct appeals to Supreme Court from orders of Tribunals. A decision in this regard by Union of India shall be taken within six months.

vii) Union Government shall carry out an appropriate exercise for amalgamation of existing Tribunals adopting test of homogeneity of subject matters to be dealt with and thereafter constitute adequate number of Benches commensurate with existing and anticipated volume of work.

viii) Issue and question of Money Bill, as defined under Article 110(1) of Constitution, and certification accorded by Speaker of Lok Sabha in respect of Part-XIV of Finance Act, 2017 is referred to a larger Bench.

ix) Section 184 of Finance Act, 2017 does not suffer from excessive delegation of legislative functions as there are adequate principles to guide framing of delegated legislation, which would include binding dictums of this Court.

Interim Relief

The Supreme Court also granted interim relief as under:

"Appointments to Tribunal/Appellate Tribunal and terms and conditions of appointment shall be in terms of respective statutes before enactment of Finance Bill, 2017. However, liberty is granted to Union of India to seek modification of this order after they have framed fresh rules in accordance with majority judgment. However, in case any additional benefits concerning salaries and emoluments have been granted under Finance Act, they shall not be withdrawn and will be continued. These would equally apply to all new members."

3 ***CIT vs. Odeon Builders Pvt. Ltd.***

[2019] 110 taxmann.com 64 (SC)/[2019] 266 Taxman 461 (SC)/[2019] 418 ITR 315 (SC): dated 21-8-2019

Income from undisclosed sources – Disallowance of expenses treating purchases as bogus – CIT(A) set aside disallowance holding that it was based solely on third party information, which was not subject to further scrutiny by AO – Order of CIT(A) affirmed by Tribunal – High Court held no substantial question of law – Appeal by Revenue dismissed by Supreme Court: (A.Y. 2008-09)

In an assessment u/s. 153A of the Income-tax Act, 1961 for the A.Y. 2008-09, the Assessing Officer disallowed an expenditure of ₹ 19,39,60,866/- treating the purchases as bogus. The Commissioner (Appeals) deleted the addition holding that the entire disallowance is based on third party information gathered by the Investigation Wing of the Department, which have not been independently subjected to further verification by the Assessing Officer. The Tribunal affirmed the decision of the Commissioner (Appeals).

The High Court affirmed the findings of the Commissioner (Appeals) and the Tribunal as concurrent factual findings, which had not been shown to be perverse and dismissed the appeal filed by the Department stating that no substantial question of law arose.

The Supreme Court dismissed the appeal on the ground of low tax effect. The Department preferred a review petition. Although the tax effect in the case was above ₹ 1 crore, that is, ₹ 6,59,27,298/-, and the Court would ordinarily have recalled its order, the Supreme Court dismissed the review petition on merits and held as under:

"i) The disallowance was based solely on third party information, which was not subjected to any further scrutiny, that the Tribunal had relied on the same reasoning and the High Court had affirmed the findings of the Commissioner (Appeals) and the Tribunal as concurrent factual findings, which had not been shown to be perverse.

ii) The review petition is dismissed."

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DIRECT TAXES

High Court

Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

1 ***Venkata Dilip Kumar vs. CIT***

Writ Petition No. 16249 of 2018, Madras High Court, Order dt. 5th November, 2019

Capital Gains – Exemption u/s. 54 – Assessee entitled for benefit of deduction u/s. 54 in respect of disputed sum, even though the said sum was not deposited in capital gain account as required u/s. 54(2) [A.Y. 2014-15]

The assessee before the Hon'ble Madras High Court was the HUF. The HUF and the Kartha of HUF in his individual capacity owned a property in Chennai with 1/4th share and 3/4th share respectively over the same. The said property was developed by entering into a development agreement on 15-4-2013 with the developer. While the 3/4th share of the property, on completion of its development, was agreed to be released in favour of the developer or his nominees, 1/4th share of the said property was agreed to be retained by the HUF. Accordingly, the HUF and the Kartha in his individual capacity deposited a portion of the amount received as consideration towards the above development project into capital gains deposit account. In so far as the HUF was concerned, it was stated that a sum of ₹ 1.50 crore was deposited in the capital gains deposit account with State Bank of India. The Revenue allowed deduction of the said sum of ₹ 1.50 crore under Section 54 of the Income-tax Act. However, the HUF claimed further deduction to the tune of ₹ 57.25 lakh under Section 54 by contending that though such sum was not deposited in the capital gain deposit account, the same was utilised for the purpose of additional expenditure towards the construction cost and that the said sum was drawn out of capital gains deposited in the same bank branch, however, in a saving bank account. The Revenue refused to grant deduction under Section 54 towards the said sum of ₹ 57.25 lakh only on the reason that it was not deposited in the capital gains deposit account and thus, the HUF having not satisfied the mandatory requirement under Section 54(2) of the Income-tax Act, is not entitled to deduction towards the said sum. The High Court noted that there was some confusion between the pleadings made before the Commissioner of Income-tax (CIT) under 264 proceedings and before the High Court. While the CIT proceeded to decide the matter as if the HUF claims deduction towards the additional cost of construction of ₹ 1,02,13,527/-, the Assessee before High Court projected the case as if the deduction sought for is only in respect of a sum of ₹ 57.25 lakhs. However, since the denial of deduction was made solely on the reason that the disputed quantum was not deposited into capital gains account, the Court was inclined to proceed further and decide the matter, since the quantum in dispute would not have any impact or relevance in answering the issue involved in the matter. The High Court was posed with a question as to whether the assessee is entitled for

benefit of deduction under Section 54 in respect of the disputed sum, even though the said sum was not deposited in the capital gains account as required under Section 54(2). After the going through provisions of the Act, the High Court observed that the intention of the legislature for granting deduction under Section 54 is that the assessee should be given the benefit of not taxing the capital gains so received by treating it as income, if he has purchased the house one year before or two years later or constructed the same within three years, from the date of transfer. Thus, this compliance is to be treated and construed as substantial compliance to consider the claim of the benefit under Section 54. Thus, it is clear that meting out the expenses towards the cost of construction of the house within a period of three years entitles an assessee for claiming deduction under Section 54. The High Court observed in the present case, the only objection raised by the Revenue was that the disputed sum has not been deposited in the capital gains account. At the same time, it was not in dispute that the assessee has deposited ₹ 1.50 crore in the capital gains deposit account and the deduction was granted to the said sum under Section 54. The dispute was only with regard to the balance sum spent on additional construction cost, which according to the Revenue, is not entitled for deduction under Section 54, since it was not deposited in capital gains account as required under Section 54(2). The Court held that the contention of the Revenue to deny the benefit of deduction to the assessee cannot be justified. Section 54(2) cannot be read in isolation and on the other hand, application of Section 54(2) should take place only when the assessee failed to satisfy the requirement under Section 54(1). While the compliance of requirement under Section 54(1) is mandatory and if complied, has to be construed as substantial compliance to grant the benefit of deduction, the compliance of requirement under Section 54(2) could be treated only as directory in nature. If the assessee with the material details and particulars satisfies that the amount for which deduction is sought for under Section 54 is utilised either for purchasing or constructing the residential house in India within the time prescribed under Section 54(1), the deduction is bound to be granted without reference to Section 54(2), which compliance, would come into operation only in the event of failure on the part of the assessee to comply with the requirement under Section 54(1). Mere non-compliance of a procedural requirement under Section 54(2) itself cannot stand in the way of the assessee in getting the benefit under Section 54, if he is, otherwise, in a position to satisfy that the mandatory requirement under Section 54 (1) is fully complied with within the time limit prescribed therein. If it is found that such utilisation was made within such time, the Revenue is bound to grant deduction.

2 ***Coimbatore Muslim Relief Fund vs. DIT (Exemptions)***

W.P. No. 4241 of 2009 Hon'ble Madras High Court, order dt. 15th October, 2019

Power to condone delay u/s. 119 – Delay in submission of Form 10 to claim exemption u/s. 11 – Registration u/s. 12AA granted later – Delay condoned

The assessee trust filed a writ petition against the order passed by DIT (Exemptions) u/s. 119(2b) for AY 1998-99 denying to condone the delay to file Form 10 to claim exemption u/s. 11(2). The assessee trust was formed on 10-12-1997 with an aim to provide rehabilitation to the people, who are victims of communal violence in the vity of Coimbatore during November/ December 1997. Trust claimed to have received contribution from the public for providing relief to the riot victims. It filed return of income on 18-9-2001 for the assessment year 1998-99 declaring 'Nil' income and the return of income was lodged. A notice under Section 148 was issued on 27-3-2002 and the assessment was completed under Section 143(3) read with Section 147 on 27-3-2003, determining the total income at ₹ 1,50,12,470/- in the absence of registration under Section 12AA. Subsequently, Trust was granted registration under Section 12AA by the order dated 2-2-2005 with effect from 10-12-1997. This was pursuant to the order of the Income Tax Appellate Tribunal in ITA

No. 4/MDS/2003 dated 27-9-2004. There was a shortfall to the extent of ₹ 36,38,830/- in application of income of the petitioner for the assessment year 1998-99. The said shortfall was brought to tax on granting registration under Section 12AA, while giving effect to the order of the Income Tax Appellate Tribunal, thereby raising a demand of ₹ 27,34,507/- with interest at ₹ 6,34,271/-. The due date for filing Form No. 10 as per Section 11(2) for accumulation of income was the due date for filing the return of income for the assessment year 1998-99 i.e., 31-10-1998. However, the trust had filed the Form No. 10 on 27-4-2005 for accumulation of funds in order to enable to identify the other victims of the riot in a systematic manner. The entire collection for the period from 10-12-1997 to 31-12-1999 was properly disbursed to the deserving victims of the riot. The trust filed Form No. 10 along with the petition to condone the delay in filing the same. However, DIT(Exemption) rejected the petition for condonation of delay by stating that the reasons for delay have not been properly explained. This was challenged before Madras High Court. The Court observed that registration was subsequently granted to the Trust by an order dated 2-2-2005 with retrospective effect from 10-12-1997 onwards. Therefore, for all practical purposes, it is to be construed that for the assessment year 1998-99 also, the petitioner was enjoying the benefit under Section 12AA on getting such registration with effect from 10-12-1997. In this case, the relevant assessment year 1998-99 and the last date for filing such return was 31-10-1998. Consequently, the Form 10 ought to have been filed on or before 31-10-1998. But in any event, filing of Form No. 10 would arise only when the petitioner enjoys the benefit of registration under Section 12AA. Admittedly, on the last date *viz.*, 31-10-1998, the petitioner was not enjoying such benefit, however such benefit was granted with retrospective effect by order dated 2-2-2005. The High Court held that the facts and circumstances would show that the trust has explained the delay in filing the Form 10 satisfactorily. Therefore, DIT (Exemption) was not justified in rejecting the application for condonation of delay, simply by saying that the trust has not satisfactorily explained the delay. The Court observed that though the delay is condonable, it is for trust to establish that accumulated income was utilised for the subsequent years only for the purpose for which it was established. Therefore, such liability exists on the trust, which they have to discharge before the first respondent. The Court remitted the matter back to DIT (Exemption) with a direction to take Form 10 on file and thereafter, to conduct an enquiry as to whether the accumulated interest was utilised for the succeeding years by the trust for the purpose for which the it was established. Such exercise shall be made within a period of eight weeks from the date of receipt of the order.

3 ***Ajay Gupta vs. CIT***

Income tax appeal No. 357 of 2010, Hon'ble Allahabad High Court, order dt. 13th November, 2019

Presumption u/s. 132(4A) is a not absolute – It is subject to corroborative evidences

Assessee an individual had filed an appeal before the High Court. Residential premises of the assessee was searched u/s. 132 on 28-2-2000. A locker which was in the joint name of assessee and his wife Smt. Aneeta Gupta, was also searched. Certain documents and jewellery were seized. Notice under Section 158-BC was issued to the assessee on 3-12-2001 for filing return of income. In compliance thereof, assessee filed return of income declaring NIL undisclosed income. Assessment for block period was completed on 27-3-2002 on undisclosed income. The CIT, Kanpur on 23-5-2003 passed order under Section 263 of the Act. In compliance to the order under Section 263, notices under Section 142(1) and a questionnaire was issued. In compliance of the said notice, assessee appeared through his legal representatives and filed his detailed reply. The Assessing Officer passed order under Section 158-BC read with Section 263 of the Act, assessing the undisclosed income at ₹ 65,33,302/- as against the declared undisclosed

income of NIL. Aggrieved by the said order, assessee filed appeal before CIT(A). The CIT(A) partly allowed the appeal of the assessee. Against said order, the revenue filed appeal before ITAT. One of the grounds of appeal was for deletion made by CIT (A) of ₹ 5,58,870/- on account of papers found during search from premises of the assessee, and the CIT had overlooked the provisions of Section 132(4A) of the Act. The ITAT allowed the appeal of the revenue on the above ground. On further appeal, the High Court observed that two loose papers were found during search from the premises of assessee. However, during block assessment proceedings, the assessee had denied the documents. In the statement recorded he had submitted that he had no concern with the documents so seized. The A. O. while passing the assessment order had only on basis of the loose papers found during search made addition to the undisclosed income of assessee while the entries of said papers remained uncorroborated. The Court observed that section 132(4A) of the Act provides that any books of account, documents, money, bullion, jewellery or other valuable articles or things found in possession or in control of any person in course of search may be presumed to be belonging to such person, and further, contents of such books of account and documents are true. But this presumption is not provided in absolute terms and the word used is "may" and not "shall", as such the revenue has to corroborate the entries made in the seized documents before presuming that transactions so entered were made by the assessee. Presumption so provided is not in absolute terms but is subject to corroborative evidence. The Court observed that the Tribunal only on basis of presumption under Section 132(4A) of the Act, reversed the finding of CIT (A), without recording any finding as to how the loose sheets which were recovered during search, were linked with the assessee. The Court held that in the absence of corroborative evidence, the Tribunal was not justified in reversing the finding by the CIT (Appeals). The matter was set aside to the Tribunal to decide afresh.

A. Harish Bhat vs. ACIT

Writ Petition No. 34252 of 2018, Hon'ble Karnataka High Court, order dt. 17th October, 2019

Principal officer u/s. 2(35) – Notice should mention some connection with the management or administration of the company - no person shall be treated as a Principal Officer, merely on surmises and conjectures

The Assessee has assailed the order dated 18-6-2018 of the ACIT whereby the assessee was treated as a Principal Officer of the Company- M/s. Kingfisher Airlines Limited for the financial year 2009-10 to 2012-13 under Section 2(35) of the Income-tax Act, 1961. The said action was challenged mainly on the ground that the objections submitted to the notice issued had not been duly considered. The High Court observed that a Principal Officer, as contemplated under Section 2(35) of the Act, used with reference to a local authority or a company or any other public body or any association of persons or any body of individuals, means:

(a) the secretary, treasurer, manager or agent of the authority, company, association or body, or

(b) any person connected with the management or administration of the local authority, company, association or body upon whom the Assessing Officer has served a notice of his intention of treating him as the principal officer thereof.

The High Court held that to treat any person as a Principal Officer, such person should be connected with the management or administration of the local authority/company or association or body. Such connection with the management or administration is the basis for treating any person as a Principal Officer. Such connection has to be established or to be supported with substantial material to decide the connection of any person with the management or administration. Without disclosing the basis, no person can be treated as

a 'Principal Officer' of the company recognizing him as the Key Management Personnel of the company. The details of such information on the basis of which the Key Management Personnel tag is made, has to be explicitly expressed in the notice of the intention of treating any person as a Principal Officer by the Assessing Officer. Neither in the show cause notice nor in the order impugned, such connection of the petitioner with the management or administration of the company M/s Kingfisher Airlines Limited was established. The phrase 'Key Management Personnel' of the company has a wide connotation and the same has to be supported with certain material unless such connection is established, no notice served on the petitioner would empower the respondent Authority to treat the petitioner as a Principal Officer. The said aspect is lacking in the present order impugned. Merely on surmises and conjectures, no person shall be treated as a Principal Officer. Hence the order was quashed.

National Refinery Pvt. Ltd. vs. ACIT,
Income tax Appeal Nos. 1166, 1169, 1170, 1172 of 2017, Hon'ble Bombay High Court, order dt. 06th November, 2019

Business expenses u/s. 37 – Legal expenses incurred to protect the directors for complaints filed against them in individual capacity not allowable. (AYs. 2005-06, 2007-08, 2008-09, 2009-10)

The assessee was engaged in the business of melting, assaying, refining and fabrication of precious metals. During scrutiny, the Assessing Officer noticed that certain legal expenses had been claimed in connection with complaints filed by one group of shareholders against the other group of shareholders/directors. The Assessing Officer found on facts that above expenses were incurred not by the company for the purpose of carrying out its business but for the purpose of defending its Directors/Shareholders in respect of complaints filed against them by another group of Shareholders. The AO holding that the above referred legal expenses cannot be allowed under Section 37 of the Act and added the same to determine the taxable income. On appeal, the CIT(A) dismissed assessee's appeal on the issue of legal expenses. Even the Tribunal confirmed the disallowance. On further appeal, the High Court observed that the legal expenses incurred by the assessee company was not for the purpose of carrying out its business and, therefore, was not allowable as expenditure under Section 37 of the Act. These legal expenses were incurred so as to protect the Directors/Shareholders of the company in respect of the complaints filed against them in their individual capacity and not in respect of their conduct in the course of carrying on the business of the appellant company. In fact, the complaint filed before the Chief Metropolitan Magistrate Court has been made against the Directors/Shareholders in individual capacities. The entire dispute between the various group of shareholders was only to acquire the management and control of the company and, therefore, these expenses are not expenses incurred for and on behalf of the company but expenses incurred for the Directors/Shareholders for their individual benefit so as to retain control and management of the company. The High Court observed that the Tribunal found that legal proceedings were also commenced against its Auditors/Company Secretary were only on off-shoot of the *inter se* dispute between different shareholders of the appellant company. Further the same Court while admitting a criminal Writ Petition, did *inter alia* observe that the complaints have been filed so as to settle personal scores between the parties. It was thus noticed that the company was no way involved in the legal proceedings taken against the Directors/Shareholders in their individual capacities. In the aforesaid facts, the Court held that the view taken by the Authorities under the Act including the Tribunal, was a possible view on facts and cannot be said to be perverse. In these circumstances, the Court held that the questions did not give rise to any substantial question of law and thus cannot be entertained. Therefore, the appeals were dismissed.

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DIRECT TAXES

Tribunal

Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

Reported Decisions

1 ***ITO vs. Bhagwat Marcom (P.) Ltd.***

[ITA 2236/Kol/2017] (Assessment Year: 2012-13), Order dated 31-7-2019 [2019] 109 taxmann.com 330 (Kolkata-Trib)

Unexplained Cash Credit – Section 68 – no addition can be made under section 68 merely because the assessee company issued its shares at premium to other companies in lieu of the shares held by said companies when there is no cash inflow

Facts

The assessee is a Private Limited Company and engaged in the business of investment and trading in shares and securities. The assessee filed its return of income for the relevant year on 23-8-2012 declaring total income at ₹ 446/- During the year under consideration, the assessee received share application money amounting to ₹ 9,85,00,000/- against issue of 98500 shares of face value of ₹ 1/- each with premium of ₹ 999/- per share. The return filed by the assessee was selected for scrutiny assessment. During the course of assessment proceedings, the AO issued the notices u/s. 131 of the Act to the Directors of the share applicant companies requiring them to personally appear before AO along with relevant details and documents justifying their investments in the assessee company. However, nobody appeared before the AO in response to the said notices. The AO, therefore, asked the assessee to produce the directors of share applicant companies along with details and documents for verification. However, the assessee failed to meet the said requirement of the AO and as a result he added the entire amount of share application money u/s. 68 of the Act in the hands of the assessee. Aggrieved with the action of the AO, the assessee preferred an appeal before the CIT(A) who deleted the addition made by the AO observing that the assessee has allotted its shares against discharge of its debts merely by recording journal entries in the books of account. Thus, there being no actual cash credit in the books of account, the CIT(A) deleted the addition made by the AO u/s. 68. The Revenue being aggrieved by the said order of the CIT(A) preferred an appeal before the Hon'ble ITAT. The Hon'ble ITAT after hearing both the parties held as under:

Held

The ITAT observed that the Assessee issued its shares to certain companies in lieu of the shares held by those companies and there was

no cash inflow involved in the said transaction and the said transaction was settled by way of journal entries in its books of account. The ITAT while coming to this conclusion relied on the Judgment of the Hon'ble High Court in the case of ***Jatia Investment Co. vs. CIT [1994] 206 ITR 718 (Cal)*** wherein on similar facts it was held that since, the respective parties did not receive cash nor did pay any cash, there was no real cash credit in the cash book. Thus, the question of inclusion of the amount of the entry as unexplained cash credit did not arise.

2 ***Smt. Madhu Gangwani vs. ACIT***

[ITA 2310/Del/2019](Assessment Year: 2010-11)/[2019] 111 taxmann.com 30 (Delhi-Trib)

Capital Gains – Section 45 r.w.s 2(47) – when the Assessee hands over possession of the property to the purchaser on full payment of sale consideration and the sale deed for the same is executed on 31-3-2009 then, the capital gain tax would be chargeable to tax in the A.Y. 2009-10 and not in A.Y. 2010-11 though the sale deed registered on 1-4-2009

Facts

The assessee filed her return of income on 14.09.2010 declaring total income at ₹ 43,41,970/- and the same was revised declaring income at ₹ 41,72,080/-. Subsequently, the assessee was served with notice u/s. 148 of the Act on the basis of the information received from ADIT (Investigation) that the assessee signed the sale agreement with Shri Rajnish Karki for sale of property for ₹ 3,25,00,000/-. During the investigation, it was found that the said property was jointly owned by the assessee and Shri Roop Chand, each was having 50% share in the property. Further, on 7-8-2008, Shri Roop Chand released his rights in favour of assessee for ₹ 29,00,000/-. Thus, the assessee became full owner of the property. Subsequently, the said property was sold to Shri Rajnish Karki on 31-3-2009 for consideration of ₹ 3.25 cr. The transfer of property was registered through sale deed on 1-4-2009. The assessee did not show the capital gains in the A.Y. 2009-10 but, the same was shown in the A.Y. 2010-11 after claiming a deduction of ₹ 2,17,12,940/- u/s. 54 of the Act. The AO was of the view that the benefit of indexation was to be restricted to the land and building purchased during F.Y. 2005-06 as 50% share in the property was purchased during F.Y. 2008-09. Further, the AO held that the capital gains of 50% share in the property was to be treated as long term capital gains and remaining 50% as short term capital gain. The AO found that the computation of capital gains made by the assessee was not correct. The AO also made certain disallowance on account of expenditure incurred by the assessee while computing capital gains. The assessee being aggrieved by the assessment order preferred the appeal before CIT(A). However, the assessee did not find any success. The assessee thereafter, preferred further appeal before the ITAT. Before ITAT, the assessee raised a legal argument that the transfer of property did not take place in the year under appeal and thus, there was no question of taxing any capital gains in this year. The assessee to support her contention filed a copy of the agreement to sell that was executed and registered on 16-1-2009 and by which the part possession of the property was handed over to the purchaser subject to part payment. Further, the assessee also challenged the reassessment proceedings before the ITAT. The ITAT after hearing both the parties came to the following conclusion.

Held

The ITAT held that Sec. 45 provides that any profits and gains arising from transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sec. 54, be chargeable to Income-tax under the head

"Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place. Further, the ITAT referred to Sec. 2(47)(v) and held that the transfer in relation to a capital asset includes any transfer which includes handing over possession of any immovable property or retained in part performance of a contract of the nature referred to in Section 53A of Transfer of Property Act, 1882. It is, therefore, clear that for levy of capital gains tax, there should be a transfer of capital asset in the previous year relevant to assessment year under appeal. The ITAT further, observed that the agreement to sell was executed and registered on 16-1-2009 whereby the part possession of the said property was handed over to the purchaser subject to part payment. Therefore, transfer of capital asset completes in preceding A.Y. 2009-10. The full sale consideration was paid and possession of the property was handed over to the purchaser. The ITAT further, referred to Sec. 47 of the Registration Act, 1908 where it is provided that registered document shall operate from the date of its execution. Thus, the ITAT came to the conclusion that the transfer of capital asset took place in preceding A.Y. 2009-10. Therefore, capital gains tax would not be chargeable to tax in the relevant assessment year i.e. A.Y. 2010-11. The ITAT therefore, set aside the orders of the authorities below and deleted the entire addition made under the head capital gains. While coming to this conclusion, the ITAT relied on the decision of the Supreme Court in the case of ***CIT vs. Balbir Singh Maini [2017] 398 ITR 531(SC).***

3 *ACIT vs. U.P. Asbestos Ltd.*
(2019) 176 ITD 518 (Lucknow-Trib)

Section 145A: Excise duty not to be added to purchases, sales or valuation of inventories – Valuation of closing stock – Exclusive method of Valuing Inventories - Excise duty rightly excluded from the value of closing stock of as the Assessee has not debited it to its trading account

Facts

The assessee is engaged in the business of manufacturing and selling of asbestos sheets and allied products and trading of asbestos fibre. The assessee filed the revised return of income declaring loss of ₹ 9.16 crore. The assessee did not add the excise duty of ₹ 2.92 crore on closing stock of its finished goods contending that the liability accrued was not due on its stock of finished goods as on 31-3-2014. The assessee did not debit the excise duty in its profit and loss account, as according to it, though it had accrued, it had not become due as on 31-3-2014. The AO did not agree with the contention of the assessee and made an addition on account of valuation of closing stock in respect of excise duty not included in closing stock and thereby reduced the loss to an amount of ₹ 6,23,97,655/- instead of ₹ 9,16,08,656/- as claimed by the assessee. Being aggrieved, the assessee filed an appeal. The CIT(A) deleted the said addition observing that the manufactured or finished goods were lying in stock and the same were not cleared from the factory and hence the liability of excise duty on finished goods of ₹ 2,92,11,000/- had accrued as the goods had been manufactured but the same had not become due as on 31-3-2014 because the goods had not been cleared and therefore, the excise duty liability, in respect of finished goods lying in stock, was not incurred. Against the said order, the revenue filed an appeal before the ITAT. After considering the arguments of both sides, the ITAT held as under:

Held

The ITAT observed that, according to Sec. 145, the books of account and financial statements are to be prepared in accordance with the regular method of accounting followed by the

assessee. However, according to section 145A, while determining the income chargeable under the head 'Profits and Gains of Business or Profession', the valuation of the purchase and sale of the goods and inventory should be not only in accordance with the method of accounting regularly employed by the assessee, but also it should be further adjusted. The excise duty is an expense which needs to be debited in the trading account. It is only if it is so debited that the credit side of the trading account will show the value of the closing stock inclusive of excise duty. This methodology is essential to be followed, so that both the sides of the trading account match *inter se*. The ITAT further noted that in the present case, there is no debit of the excise duty to trading account. Further, in Notes to Accounts, the assessee has shown the excise duty as a contingent liability, which means the liability of excise duty has not crystallized year under consideration. Further, no excisable item of the closing stock was removed from the factory premises till the end of the accounting year. The ITAT held that where no excise duty, etc., were added to purchases, sales or valuation of inventories and no excisable item of closing stock was removed from factory premises till end of accounting year, following net method of valuation of closing stock, excise duty had rightly been excluded from value of closing stock of finished goods at year end. On the aforesaid contentions, the ITAT dismissed the appeal filed by the revenue.

Unreported Decisions

Galaxy Care Laparoscopy Institute Pvt. Ltd vs. JCIT

[ITA No: 1579/PUN/2015] (Assessment Year: 2011-12), order dated 3-9-2019

Sections 32, 36(1)(iii) & 37 – Recharacterization of payments – Mere mentioning of lease agreement or hire purchase agreement on the title would not determine the nature of agreement. It is the terms and conditions and covenants of agreement that really determine the nature of agreement

Facts

The assessee, a private limited company runs a hospital. For the year under consideration, the assessee took on lease the equipment from Da Vinci Surgical System' from Cardiac Research & Care Foundation ("CARE"), a public charitable trust registered u/s. 12A and subsequently claimed a deduction of lease payments while calculating its business income. During the course of the scrutiny assessment proceedings, the AO disallowed the said claim on the following observations:

i. As per the terms of lease agreement, the equipment was to be transferred to the assessee. Hence, the alleged lease rents are in fact instalments for acquiring a capital asset.

ii. Since, two trustees of CARE are the Directors of Quality Care India Ltd., the company having substantial interest in the assessee company, the provisions of section 40A(2)(b) are attracted.

iii. The value of the asset is glaringly disproportionate to the written down value calculated as per Act.

Being aggrieved, the assessee preferred an appeal before the First Appellate Authority but did not succeed. Thereafter, the Assessee approached the ITAT. Before the ITAT, in addition to the submissions made before the AO as well as the CIT(A), the Assessee requested the ITAT to allow its alternate claim regarding the allowance of depreciation and interest if its main claim of a deduction of lease payments is not accepted. On the other hand,

the DR requested the ITAT to confirm the order of the AO. After hearing both the sides, the ITAT held as under:

Held

The ITAT analysed the controversy and noted that the authorities below disallowed the assessee's claim of lease payment as revenue expenditure primarily on the ground that at the end of lease period, the asset would be transferred to the assessee and the value of asset at which it is transferred to the assessee is disproportionate to the written down value computed under the provisions of the Act. The ITAT perused the lease agreement and observed that it was mutually decided between both the parties that ownership of equipment shall be transferred to the lessee at the end of lease term and the option to own or to refuse transfer of ownership of equipment at the end of lease period was not available to the assessee. Further it was observed that the terms and conditions of the agreement though depicted as 'finance lease' transfer the equipment under consideration to the assessee at the end of the lease period. The ITAT disapproved the reliance of the Assessee on the decisions of ***CIT vs. Tata Robins Fraser Ltd [2012] 253 CTR 227 (Jharkhand)*** and held that mere mentioning of lease agreement or hire purchase agreement on the title would not determine the nature of agreement. It is the terms and conditions and covenants of agreement that really determines the nature of agreement. In the light of the abovementioned observations, the ITAT construed the said transaction as purchase of an equipment as against the lease arrangement as claimed by the assessee. With regard to the contention of the department on the applicability of Sec. 40A(2)(b), the ITAT noted that there is no mention of trust in the list of persons mentioned in clause (b) of sub-section (2) and after referring to the decision of the Delhi High Court in the case of ***Shanker Trading (P.) Ltd. vs. CIT [2012] 254 CTR 44 (Delhi)***, held in favour of the assessee. In addition, thereto the ITAT rejected the contention of the department about the value of the equipment and observed that the transaction between the assessee and CARE is at arm's length. As far as the alternate prayer of the assessee was concerned, the ITAT in the first place did not find any force in the action of the CIT(A) of rejecting the alternate plea of the Assessee by placing the reliance on *explanation* 3 to Sec. 43(1). The ITAT from a perusal of the assessment order noted that the AO during the assessment proceedings had nowhere observed that the transfer of asset was for reducing the tax liability and the mandatory condition for invoking Explanation to Section 43(1) is not satisfied. While coming to the aforesaid observation, the ITAT referred to the decision of the Madras High Court in the case of ***CIT vs. Sekar Offset Press [1995] 214 ITR 516 (Madras)***. The ITAT further held that the value of underlying equipment as set out in the agreement should be accepted for the purpose of determining depreciation in the hands of assessee and the interest component in the lease rentals should be allowed as deduction u/s. 36(1)(iii) of the Act. On the aforesaid observations, the ITAT accepted the alternate claim of the assessee and partly allowed the appeal.

M/s. Bhagwati Colonizers P. Ltd. vs. ITO

ITA No. 169/ASR/2015 vide order dated 22-10-2019

Section 254 - Mistake of counsel may be taken into account while considering the condonation of delay. Claim that the delay was caused by the Counsel not communicating the order has to be accepted unless it is shown that blame put on counsel is with *mala fide* intentions in order to cover up mistake/lapse on the part of the assessee. As per human conduct

and probabilities, a professional counsel cannot be expected to admit his lapses as it may affect his reputation

Facts

The condonation of delay in filing an appeal before the ITAT was referred to the third member on account of the difference of opinion between the judicial member and the accountant member. In the facts under consideration, the assessee had preferred an appeal before the CIT(A) on merits that was decided against the assessee and a copy of the same was served on the address given in Form 35 that happened to be an office address of the authorised representative (AR) of the assessee. However, the said order remained to be communicated to the assessee by the said AR and the assessee for the first time got to know about the same only at the time of the penalty proceedings. The assessee thereafter immediately made an application at the office of the CIT(A) that was supplied to the assessee only after one year from the date of application. However, the assessee subsequently preferred an appeal to the ITAT immediately within the prescribed time after the receipt of the copy provided by the office of the CIT(A). It was the contention of the assessee before the ITAT that there was sufficient cause for the assessee in preferring the appeal belatedly and the delay was to be condoned in such a scenario. The assessee cited various decisions before to buttress the aforesaid contention. On the other hand, the DR opposed to the said contentions. After hearing both the parties and going through the contrary views as expressed by the judicial member and the accountant member, the third member has decided the issue as under:

Held

The Hon'ble third member referred to various case laws and observed that in the matter of condonation of delay in filing appeals beyond the limitation period, the courts are empowered to condone the delay, provided the litigant is able to demonstrate that there was "sufficient cause" in preferring appeal beyond the limitation period. The Courts have also held that the expression "sufficient cause" should receive liberal construction so as to advance substantial justice. It was noticed that there was no dispute that the delay in filing an appeal occurred as the original order served on the AR of the assessee remained to be communicated to the assessee by the said AR. The third member appreciated the general fact that the assessee should not be put in trouble for the mistake, if any, committed by a counsel once an assessee engages him and places complete reliance on his expertise. While dealing with the aspect of failure on the part of the assessee to obtain a letter from the said AR, the third member accepted the submission of the assessee and held that the assessee could not collect a letter from the Counsel in view of the strained relationship. The Hon'ble Bench accepted it as a reasonable explanation after taking into account human conduct and probabilities especially as a professional counsel cannot be expected to admit his lapses, lest it should affect his reputation. The Hon'ble Bench gave weightage to the fact that even the office of the CIT(A) took one year to provide a copy of the said order to the assessee. On the aforesaid observations, it was concluded that the assessee had shown sufficient cause for the delay in filing an appeal and held that the delay deserved to be condoned.

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INTERNATIONAL TAXATION

Case Law Update

CA Tarunkumar Singhal & Dr. Sunil Moti Lala

A. HIGH COURT

1 ***CIT vs. Honda Motors Co. Ltd.***
[TS-1076-HC-2019] (Delhi) - ITA No. 945 of 2019, Assessment Year 2007-08

Once arm's length principle has been satisfied, there can be no further profit attributable to the assessee, even if it has a Permanent Establishment (PE) in India

Facts

i) The Tribunal had quashed reassessment orders (for AYs 2004-05 to 2007-08) issued in case of assessee noting the Supreme Court's decision in assessee's own case and in the case of E-funds IT Solutions.

ii) In the case of E-funds IT Solutions, Supreme Court held that the fact of assessee having a PE in India was of no consequence since the transaction was found to be at arm's length. Therefore, the impugned notices for reassessment based only on the allegation that the assessee has PE in India could not be sustained once arm's-length price procedure had been followed.

iii) Aggrieved, the Revenue filed an appeal before the High Court.

Decision

i) In view of the Supreme Court's ruling, the High Court held that the finding that the assessee had a PE in India was inconsequential since in the present case the transaction was found to be at arm's length.

ii) Further, since the issue was concluded by the High Court in ITA 562/2019, following the same as well as the decision of the Supreme Court, the Court held that no question of law arose for the High Court's consideration and thus, the appeal was rejected.

2 ***Lufthansa Cargo AG vs. DCIT and ANR***
[TS-696-HC-2019] (Delhi) – WP (C) 9136 of 2019 and CM APPL 37760 of 2019, Assessment Year: 2020-21

The Court quashed the certificate under section 197 arbitrarily fixing the rate of TDS at 0.5% on payments made to a German airline company. It directed the AO to issue a fresh certificate under section 197 and held that till then rate of withholding on payments made by Indian deductors to assessee would be NIL, as its income was not

liable to tax in India in view of Article 8 of the India-Germany DTAA

Facts

i) The Petitioner, a Company incorporated in Germany, was in the business of transportation of mail, livestock and goods by air through its aircrafts in international traffic. It was a tax resident of Germany which was also its place of effective management for the purposes of the Income-tax Act and the India-Germany DTAA.

ii) The Petitioner stated that in compliance with the provisions of Section 195 of the Act, the Petitioner filed an electronic Form 13 application with the AO requesting a certificate to be issued under Section 197(1) of the Act allowing a NIL rate of tax withholding to the deductors, as cargo agents on payments to be made to the Petitioner during Financial Year 2019-20.

iii) The Petitioner contended that the impugned certificate dated 29 May, 2019 arbitrarily fixed the rate of deduction of tax at source at 0.5% even though under the DTAA, Petitioner's income was not taxable in India since as per Art 8 of the DTAA, profits from operation of aircrafts in international traffic shall be taxable only in the Contracting State in which the place of effective management is situated.

iv) The AO had proposed issuance of certificate under Section 197 directing payers to deduct tax at NIL rate.

v) The DCIT sought information/reasons for claiming applicability of Art 8 of the DTAA. Previous years assessment statements were called for, which showed the taxable income was accepted as NIL. However, DCIT held that to protect the interest of Revenue, a certificate should be issued at WHT rate of 0.5%.

vi) The Petitioner preferred a writ petition to assail the orders/directions issued by DCIT under Section 197 of the Act directing withholding of TDS at the rate of 0.5% for Assessment Year 2020-21.

Decision

i) The Court held that there was no discussion by the Revenue as to on what basis the decision was taken to withhold tax at source in respect of payments made to Petitioner in India at 0.5%. There had been complete non-application of mind to the germane and relevant considerations by the Respondents while dealing with the Petitioner's application.

ii) Further, the Court relied on the decision in ***Bentley Nevada LLC vs. Income Tax Officer in WP(C) No 7744 of 2019*** decided by it on 29th July, 2019 wherein the effective rate of tax was worked out at 1.04% of the total revenues and the Court had quashed the order under Section 197 allowing deduction of the tax at source at 5% from the payments made to the Petitioner by Indian customers.

iii) The Court held that the situation in the present case was even better for the Petitioner as the total income had been assessed in the return as NIL.

iv) The Court thus quashed the certificate dated 29th May, 2019 and directed Respondents to apply mind afresh and issue a fresh certificate.

v) It further gave a direction that until a fresh certificate was issued the Petitioner's receipt of payment would be subject to NIL rate of deduction of tax at source in respect of Indian payments.

3 ***FCI OEN Connectors Limited vs. DCIT and ITO***

[TS-707-HC-2019] (Kerala) – WP (C) No. 11952 of 2019, Assessment Year: 2015-16

As the assessee had not opted for e-proceedings, the time limit to file objections before the DRP would have to be computed from the date of manual receipt of the draft assessment order, notwithstanding that the same was also electronically received on an earlier date

Facts

i) The Petitioner, a public limited company, was engaged in the business of manufacture of connectors and other articles.

ii) The Petitioner was served with a notice under Section 143(2) on 15th April, 2016 and thereafter with notices under Section 142(1) of the Act requiring it to produce various documents for assessment purposes.

iii) With effect from 2017, as part of the Government initiative towards e-Governance, there was a move to shift to e-proceedings facility for completion of assessments. Circulars and instructions were issued by the Government of India, Ministry of Finance, in the Department of Revenue, requesting assessees to switch over to the e-proceedings facility for completion of their assessments. The e-proceedings facility was initially made mandatory in seven metro cities. In Cochin, it was optional.

iv) The Petitioner did not opt for e-proceedings and thus, manually filed the documents sought.

v) On a reference to the TPO under Section 92 CA of the Act, the TPO by order dated 26-10-2018 recommended certain adjustments to the computation of income. Thereafter, the AO prepared a draft assessment order based on the recommendations of the TPO, in terms of Section 144(C) of the Act and served a copy of the draft assessment order to the Petitioner electronically on 31 December 2018 and manually on 5th January, 2019.

vi) As per sub section 2 of Section 144(C) the petitioner has to file his objections to the draft assessment order before the DRP, within 30 days of receipt by him of the draft order.

vii) Petitioner's objection was received by the DRP on 1st February, 2019.

viii) The DRP issued show cause notice asking the Petitioner to show cause as to why the objection preferred by it should not be rejected on the ground that it was received by the panel more than 30 days after the service of the draft assessment order through the electronic mode on 31st December, 2018.

ix) The Petitioner informed DRP that the objection was within 30 days of the manual service of order. DRP rejected the Petitioner's contention.

x) However, on 22nd February, 2019 itself, the Assessing Authority passed an assessment order without taking note of the objections filed by the Petitioner to the draft assessment order

Decision

i) The Court held that when the Petitioner had not opted for the e-proceeding facility, and had chosen to have its assessment proceedings continued in the manual mode, the receipt of the draft assessment order in the manual mode has to be seen as the date of service of the draft assessment order.

ii) It would also be an aspect of fairness in tax administration that the assessee is not

prejudiced on account of service of an order, through a mode that he did not opt for. The Court must also remind itself that, in the event of an ambiguity in construing the provisions in a taxing statute, it has to take a view that favours the assessee.

iii) Thus, objections filed by the Petitioner, being within 30 days of manual service of the order, was within time.

iv) In matters involving transfer pricing, the assessment order by the AO must necessarily follow the findings of the DRP and hence, based on the finding that order of the DRP was illegal, it held that order of assessment, that did not await the decision of the DRP on merits, is also illegal.

v) The writ petition was therefore allowed and orders of the Respondents were quashed. DRP was directed to consider the objections of the Petitioner on merits and pass fresh orders within 3 months. The AO was then directed to complete assessment proceedings taking note of the order of the DRP and after hearing the Petitioner within 3 months from receipt of order of DRP.

vi) It was clarified that the judgment in the present case was based on the facts and was not to be cited as a precedent.

B. TRIBUNAL DECISIONS

4 ***M/s India Convention and Culture Centre Pvt. Ltd. vs ITO***

[TS-594-ITAT-2019(DEL)] Assessment Year: 2014-15

Valuation of shares under section 56(2)(viib) of the Act – Valuation based on the fair value of assets, cannot be rejected – Held in favour of the assessee

Facts

i) The assessee company filed its tax return for a financial year declaring a loss. During the same year, the assessee had issued shares at a premium.

ii) The assessee owned agricultural land. On 14th June 2012, the competent authority allowed the land to be used for setting up a convention centre. This resulted in a change in the fair value of the land.

iii) The AO determined the FMV of shares under Rule 11UA of the Income-tax Rules, 1962 (Rules) and added the entire premium to the total income of the assessee.

iv) The Commissioner of Income-Tax (Appeals) [CIT(A)], considering the share application money as a liability and correcting certain other error in the valuation of the AO, revalued the shares. Thus, a partial relief was given to the assessee as against the original relief claim.

Decision

On appeal, the Tribunal held in favour the assessee as under:

A) The assessee contended before the Tribunal that:

   i) The competent authority allowed the land to be used for setting up a convention centre. This resulted in a change in the fair value of the land.

   ii) As per *Explanation (a)* to section 56(2)(viib) of the Act, FMV of shares shall be the higher of the value determined under Rule 11UA of the Rules or the value of assessee's assets as substantiated by the assessee to the satisfaction of AO.

   iii) The AO cannot insist on following one particular method.

   iv) Valuation of shares has to take into consideration various factors and should not be simply based on book value.

v) The circle rate of land was substantially higher than its book value, and the same should be adopted as the FMV of the land instead of the book value.

vi) On considering the circle rate of land as its FMV, the value of shares under section 56(2)(viib) of the Act is determined at a much higher rate than the premium rate at which the shares were issued by the assessee. Therefore, no addition is called for under section 56(2)(viib) of the Act.

B) The Department contended as under:

i) The assessee had failed to explain how the change in land use for institutional purpose would increase the fair value of shares.

ii) In the absence of cogent reasons substantiating the increase in FMV of land, the book value of the land should be considered as a metric for valuing the shares of the assessee.

iii) The conversion charges paid by the assessee to local authorities for obtaining change in land use permission would have been added to the book value of land, thereby increasing its value to that extent.

C) The Tribunal held and observed as follows:

i) Valuation of shares has to be made on the basis of various factors and not merely on the basis of financials.

ii) *Explanation* (a) to section 56(2)(viib) of the Act prescribes that the FMV of shares shall be the higher of the value determined under Rule 11UA of the Rules or the value of assessee's assets as substantiated by the assessee to the satisfaction of AO.

iii) The assessee had obtained the permission of the competent authority for change of land use from agricultural to institutional, resulting in higher circle rate of land.

iv) Valuation adopted by the assessee cannot be rejected where the assessee has demonstrated with evidence that the FMV of the asset is much more than book value.

v) Hence, the FMV of shares as substantiated by the assessee should be accepted and addition of share premium made by the AO and confirmed by the CIT(A) is deleted.

5 *Hitachi High Technologies Singapore Pte Ltd vs. DCIT*

[TS-558-ITAT-2019(DEL)] Assessment Years: 2002-03 to 2007-08

India-Singapore DTAA – Article 5(7)(e) - Liaison Office in India – Whether a permanent Establishment – Held, on facts, that Article 5(7)(e) of the DTAA envisaged a narrower exclusion than India's Treaties with USA and Canada – the Assessee's L.O. in India constituted a PE in India

Facts

i) The assessee, a Singapore company and a wholly owned subsidiary of Hitachi High-Technologies Corporation, Japan, was engaged in trading operations across Southeast Asia. In 1988, the assessee established an LO in India for providing 'preparatory and auxiliary services, including market research and liaison activities'.

ii) Based on employee statements recorded in a survey conducted at the LO's premises in 2008, the AO initiated assessment against the Assessee under the Income-tax Act,

1961 ("ITA") for assessment years 2002-03 to 2007-08. A draft assessment order was passed holding that the LO was negotiating and executing contracts for the Assessee in India, and was not limited to undertaking preparatory and auxiliary activities, and hence it was a PE of the Assessee in India under Article 5 of the India-Singapore treaty.

iii) The income of the assessee attributable to the alleged PE was computed by applying the assessee's global profit margin to sales made in India and attributing 50% thereof to the PE. Total addition of INR 72 million was made for the batch of six years assessed.

iv) The DRP summarily upheld the draft order, following which the AO passed the final order. On appeal, the Tribunal set aside the order directing the DRP to re-adjudicate passing a speaking order.

v) The DRP re-adjudicated and framed its order based on which the AO passed another final order. This time the additions made were to the tune of INR 1.23 billion.

vi) The assessee once again approached the Tribunal in appeal against the final order, on four main grounds discussed below.

Decision

Upon the assessee's appeal, the Tribunal held as under:

i) During re-adjudication, the DRP altered the manner of attribution of profits to the PE, resulting in enhancement of the assessment. The Tribunal held that the DRP had merely followed its directions in re-adjudicating the matter. It further observed that the DRP is a continuation of assessment proceedings, intended as a corrective mechanism to guide the AO, and is not an appellate forum – unlike the Commission of Income Tax (Appeals).

ii) The Tribunal observed that while its powers in adjudicating appeals were very widely couched, their power to enhance an assessment in the absence of cross appeals or cross objections by the revenue was limited. For this, the Tribunal relied on the decision of the Supreme Court in ***State of Kerala vs. Vijaya Stores (1978 4 SCC 41***). On this basis, the Tribunal stated that the addition to the assessee's income in the proceedings should be restricted to INR 72 million – being the additions made in the first instance.

Re: LO of the assessee constituting a PE in India

iii) The Tribunal analysed the text of the PE exclusion clause in Article 5(7)(e) of the India-Singapore tax treaty, observing that the words 'for similar activities' used after 'advertising', 'supply of information' or 'scientific research' were noticeably different from the phrase 'for other activities' used in India's treaties with Canada, or the USA. The use of 'similar activities' necessitated the application of the principle of *ejusdem generis*, meaning the scope of the residuary phrase had to be interpreted in light of the words preceding it, being: advertising, supply of information and scientific research. Therefore, unless the LO was being used only for advertisement, for supply of information, for scientific research, or activities similar to these three which have preparatory or auxiliary character, they could not fall in the PE exclusion clause.

iv) The nature of activities, as evidenced by the statements gathered during the survey, were market research and sales promotion – *sine qua non* for a trading business, and hence could not be regarded as preparatory or auxiliary, especially under the restricted

scope of the exclusion clause in the India-Singapore treaty. Therefore, the Assessee had a PE in India under the treaty.

Re: Attribution of profits to the PE

v) The DRP directed the AO to use the profit margin of an independent agent used by the assessee – called ForeVision – as an internal comparable, because it found its activities to be similar to that of the LO.

vi) The Tribunal, on the basis of Article 7 of the India-Singapore tax treaty and the decision of the Supreme Court in ***DIT vs. Morgan Stanley [2007] 292 ITR 416 (SC)*** stated that the attribution of profits of the PE was to be determined as if the PE was an independent enterprise, with reference to an analysis of functions performed, assets employed, and risks assumed ("FAR Analysis") by the PE. The Tribunal observed that no such comparative FAR Analysis had been undertaken in respect of the LO and ForeVision, and that based on the business profiles ForeVision was not a good comparable. It then observed that the LO was performing routine and limited functions and was operating in a risk-free environment, in which case a profit attribution by the revenue of 163% to 2357% was absurd, and the allocation should have been done by applying the Transactional Net Margin Method.

(***Note***: In the present case, to conclude on whether the activities of the LO were preparatory and auxiliary in nature, the Tribunal relied on employee statements - specifically correspondence between the LO and the head office - where statements have been made that the representative office clearly was actively involved in commercial activities. This sheds light on the importance of written communication within an organization, and that such communication can also be used as evidence, especially where survey operations are carried out.)

M/s. Keva Industries Pvt. Ltd vs. ITO

[TS-674-ITAT-2019(Mum)] Asssessment Year: 2015-16

Valuation of Shares - addition u/s. 56(2)(viia); Rule 11U inapplicable to foreign co. shares pre-2019 amendment – Held in favour of the assessee

Facts

i) Keva Industries Pvt. Ltd (assessee) is a company engaged in the business of manufacturing and distribution of natural and synthetic essential oils and aromatic chemical resinoids.

ii) The Directors of assessee-company had acquired shares in the year 2008 at ₹ 34/- from a Singapore based company (an investment company having main investment in S. H. Kelkar & Co. Ltd.), named "KNP Industries Pte Ltd." (in which assessee's directors were also directors).

iii) Thereafter, assessee's directors sold 400,000 shares to assessee-company, at the same rate of ₹ 34/- per share, on the basis of valuation done as per Discounted Cash Flow Method (DCF) of M/s KNP Ltd (which was taken at USD 0.50 (Dollar rate considered at ₹ 68)). Both the assessee's directors booked Long Term Capital Loss(LTCL) of ₹ 51,64,854/- on the transaction due to indexation. The assessee submitted the valuation report made as per a CA firm as also produced the audit report of KNP Ltd. for the years 2015 & 2016.

iv) The AO compared the results with the projection made during the valuation of shares as per DCF method, and observed that there was huge variation in the projections. Thus, the AO held that the valuation under DCF method worked out by the assessee as per the data provided by the management / directors was nothing

but an eye wash and totally unrealistic and accordingly not acceptable. Pursuant to which, he rejected the valuation of shares carried out by an independent valuer using DCF method and proceeded to adopt the book value of shares as per the provisions of Rule 11UA(2)(a) of the Income Tax Rules. The AO for this purpose, observed that since on the date of issue of shares, KNP Ltd did not have its audited financials, the determination of fair market value (FMV) was made on the basis of audited balance sheet for the previous year ended 2014.

v) Against this background, the AO proceeded to make an addition u/s. 56(2)(viia) to the tune of ₹ 107,40,00,000/- (400,000 shares * (2719-34)) by treating the difference between the FMV of the shares and the purchase price of the shares by the assessee. On further appeal, CIT(A) upheld the order of the AO.

Decision

The Tribunal observed and held in favour of the assessee as under:

A) Re: Application of Rule 11UA of the Income-Tax Rules:

i) At the outset, the Tribunal noted that provisions of Rule 11UA(2) of the Rules are applicable only in the case of issue of shares by an unlisted company under the provisions of section 56(2)(viib). The Tribunal further takes note of the term “Balance Sheet” as defined in Rule 11U and clarifies that “since the shares of a foreign company were acquired by the assessee company in the instant case, the ld AO ought to have relied on the balance sheet as audited by the auditor appointed under the Indian Companies Act.”

ii) The Tribunal noted that the AO had relied on the balance sheet of KNP Industries Pte Ltd, Singapore, which was prepared in accordance with the Singapore Companies Act. Thus the Tribunal clarified that “the case of the assessee falls squarely on clause (ii) of the definition of “Balance Sheet” as defined in Rule 11U of the Rules supra. Hence it is mandatory to draw a balance sheet as on the valuation date i.e. 10-2-2015 /11-2-2015 (being the date of purchase of shares by the assessee company) and that the said balance sheet should have been audited by an auditor appointed under section 224 of the Companies Act, 1956.”

iii) Therefore the Tribunal stated that “it could be safely concluded that the ld AO had applied the valuation method on a different date which is not in accordance with law and that since the computation mechanism provided in Rule 11UA of the Rules is not applicable to the facts of the instant case, the provisions of section 56(2)(viia) of the Act also could not be invoked.”

iv) Further the Tribunal held that since the assessee-company had acquired the shares of a foreign company, “We also find the provisions of section 56(2)(viia) of the Act refers to transaction of acquisition of any property being shares of a company not being a company in which public are substantially interested. Since foreign company does not fall in the above category, the provisions of Section 56(2)(viia) of the Act cannot be said to apply to the above transaction.”

v) The Tribunal further holds that the provisions of section 56(2)(viia) of

the Act cannot apply to a foreign company as the relevant Rule 11U which defines "balance sheet" was not applicable to a foreign company. The Tribunal further found that the amendment in this regard was brought in Rule 11U with effect from 1-4-2019 under Rule 11U(b)(ii) of the Rules. Thus the Tribunal ruled that "This amendment is only prospective in nature and cannot apply to the year under appeal. We hold that the case of the assessee company herein falls under old provision of Rule 11U(b)(ii)."

vi) The Tribunal explicated that the legislature had sought to rectify the mischief hitherto prevailing up to Asst. Year 201819 in the statute/rule and had accordingly brought an amendment effective from Asst. Year 2019-20 onwards to curb the loophole available in the Act/Rules, hence the Tribunal held that "the pre-amended definition of balance sheet cannot include foreign company therein."

B) Re: Valuation of Shares:

i) The Tribunal observed that in 2005, in case of S. H. Kelkar & Company (in which assessee's directors were shareholders & in which KNP was part of promoter group), there was a major disagreement between groups of shareholders and their families, which ultimately resulted in separation of two factions from the company, whereby the Company Law Board passed an order of settlement keeping in view the interests of the stakeholders.

ii) The Tribunal further observed that as a part of the settlement, the promoters had to raise capital to fund settlement cost of the existing factions from the company, whereby the banks demanded exorbitant rates of interest. Therefore, the promoters decided to raise capital in the form of private equity from M/s. Blackstone Capital Partners (Singapore).

iii) Next, the Tribunal noted that in accordance with above, a shareholders agreement was executed, whereby it was agreed that protection to the Investors in the event of their exit without procuring the agreed IRR on their investment, i.e. in the event of exit of Blackstone from SHK without procuring the agreed IRR on investment, the promoters of the company would become personally liable to make good the loss incurred by Blackstone. For this purpose, the Tribunal observed that, the shares of SHK held by KNP were placed in escrow-account which was in the custody of Deutsche Bank AG, Hongkong Branch (which acted as the Escrow Agent to the above arrangement). It was agreed that if any specified event occurred (resulting in loss of wealth for Blackstone), the escrow agent shall handover the shares of SHK held in the escrow account to the said M/s. Blackstone

iv) Thus the Tribunal remarked that "During such period when shares were placed in escrow, KNP Industries Pte Ltd could not have sold the shares in the open market due to the overriding charge created. Further, if any adverse event was triggered, the shares would have been directly handed over by escrow agent to Blackstone (who had been roped in as an investor). In nutshell, the value of shares of S. H. Kelkar & Co. held by KNP Industries Pte Ltd. was virtually zero."

v) The Tribunal rejected AO's action of refuting assessee's valuation per share based on DCF model due to variations arising in actual *vis a vis* the projections, and held that "From due appreciation of the entire facts narrated above, we find that the valuation of USD 0.50 per share of shares of KNP arrived in the valuation report is to be accepted as just and fair in view of the fact that the main investment in KNP Industries Pte Ltd is in the shares of S. H. Kelkar and Company Limited."

vi) The Tribunal further noted that, as on the date of valuation of shares, the valuer did not have the benefit of the actual figures which had happened subsequent to the valuation date. The Tribunal further acknowledged that, "It is a calculated business risk and commercial decision taken by the respective investors by placing reliance on the share valuation report."

C) Re: Compliance with Law:

i) The Tribunal noted that assessee had argued that in the year 2015, as RBI/FEMA had changed their norms with regards to investment in foreign shares by a resident individual, therefore, its directors had transferred their shares to assessee in order to comply with the legal requirement.

ii) The Tribunal observed that, "Infact for acquiring the shares worth ₹ 1.36 crore from the directors, the assessee company in turn took loan of the very same amount from its directors to make payment to the directors for acquisition of shares of ₹ 1.36 crore. Therefore the motive of the transaction was not to make any gains but to comply with the law."

iii) The Tribunal further noted that the assessee company did not have any independent activity apart from the above acquisition of shares. The Tribunal accepted assessee's argument that as the value at which the shares were acquired by the assessee company, corresponded to the value at which the shares were originally procured by the directors, therefore "This itself corroborates the fact that the entire exercise of change in ownership was undertaken only to comply with the RBI/FEMA regulations and there was no intention to make any gains out of the said transaction."

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- Valuation of Fixed Assets (Movable and Immovables)
- Valuation of Intangible Assets
- Valuers for liquidation value of Corporate Debtors under IBC 2016 / IND AS
- Useful Life of Assets as per Companies Act 2013
- Evaluation of Project implementation as Lenders' Independent Engineers (LIE)
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- Assessment of Impairment of Assets as reqd by AS-28
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INDIRECT TAXES

GST Gyan – Rule 36(4)- Imposing the impossible?

CA Kush Vora

Introduction

It is often said that while shearing sheep, it is well to stop when the shearer gets down to the skin. The said metaphor will apply while levying taxes as well. The government should always bear in mind the level of regulations and restrictions to be imposed so as not to eventually make it impossible to comply with a particular law.

Within a span of two years, the government has unearthed series of frauds in GST relating to fake invoicing cases. Coupled with it, the government has missed its target GST collection of ₹ 1 lakh crore for quite a few months. In view of the government, majority things would attain clarity, if ITC of the dealers are validated and verified online and without any human interference. Hence, the introduction of new rule 36(4) of CGST Rules which puts restriction on claiming ITC and forces a taxpayer to compulsorily undertake reconciliation with GSTR-2A. May be this measure is taken to move an inch closer to filing of new proposed GST w.e.f. 1-4-2019.

What exactly is Rule 36(4)?

The said rule is introduced by way of Notification No. 49/2019 dated 9-1-2019 and reads as under:

> *"(4) Input tax credit to be availed by a registered person in respect of invoices or debit notes, the details of which have not been uploaded by the suppliers under sub-section (1) of section 37, shall not exceed 20 per cent of the eligible credit available in respect of invoices or debit notes the details of which have been uploaded by the suppliers under sub-section (1) of section 37."*

Details under Section 37(1) refers to return in form GSTR-1 and the macro result of auto population of GSTR-1 of all vendors of a tax payer is nothing but Form GSTR-2A. Hence, the rule incidentally refers to GSTR-2A wherever reference to S. 37(1) is made.

The language of the rule is quite intricate and the said rule when interpreted profoundly (in accordance with clarification issued by the Board), eventually prescribes a formula for availing ITC. The same is as under:

ITC available in GSTR-2A + 20% x (ITC available in GSTR-2A). In no case shall the ITC as per the formula exceed the actual eligible ITC. Therefore, it may be correct to conclude that 83% matching is achieved in GSTR-2A, then only full ITC may be available. In cases wherein there is less than 83% matching some portion of ITC may be lapsed. The same is tabulated hereunder simplistically:

- **If ITC as per GSTR-2A is more than 83% of ITC as per books**

  Full ITC as per books can be claimed in GSTR-3B

- **If ITC as per GSTR-2A is less than 83% of ITC as per books**

  ITC available in GSTR-2A + 20% x (ITC available in GSTR-2A)

The Board has issued a Circular dated 11-11-2019 clarifying strict compliance of the rule on a monthly basis while filing of monthly GST returns. The above mentioned exercise/ reconciliation on a monthly basis can be cumbersome and impractical in many cases. In order to comply with the above formula, one may need to undertake onerous task of multiple reconciliations, enumerated hereunder:

1. Downloading GSTR-2A from the portal (which takes minimum 20 minutes) and check all entries of GSTR-2A so as to eliminate ineligible and wrong credits passed on;
2. Reconciling entries in purchase registers and eliminate ITC of past invoices from the current period GSTR-3B;
3. Many times the above reconciliation will have to be undertaken on a consolidated period basis since the beginning of financial year so as to plug the time gap between filing of returns by the supplier and the recipient;
4. Reconciling GSTR-2A and GSTR-3B and identifying non-filers and quarterly filers;
5. Following up with non-filers to appropriately file their GSTR-1;
6. Repeat above steps multiple times between 11th and till the time of filing of GSTR-3B;
7. The most difficult part – Keeping a track of invoices of which ITC is not availed since the same was not appearing in GSTR-2A and subsequently check every month's GSTR-2A for such credits. Each and every month will require separate and offline reconciliation sheets.

In view of the author, the above steps are challenging to implement and comply at the time of filing of monthly returns. Accordingly, strong representation to simplify the said rule is the need of the hour.

Having said the above, it would be imperative to understand the statutory framework and legal provisions as provided under the GST Act.

Legislative framework

It is well-settled and well-accepted principle that the Rules made under any statute can by no means go beyond the power conferred by the Act or extend the scope of the Act. Accordingly, let us look at the provisions of CGST Act as to whether it enables to provide for such restriction by way of rules. Chapter V of the CGST Act consisting of Sections 16 to 21 deals with Input Tax Credit. Chapter IX of CGST Act, consisting of Sections 37 to 48 deals with filing of returns and *inter alia*, newly inserted Section 43A will be of much relevance.

1. **Section 43A of CGST Act**

   Procedure of furnishing of return and availing ITC

   In view of the author, Section 43A is not enacted to cover cases of existing filing of returns i.e., GSTR 3B vs. GSTR 2A, but to provide teeth to new GST returns proposed to be implemented w.e.f. 1-4-2019. Perhaps that is the reason the said Section 43A is not yet made effective and accordingly at this point of time, Section 43A is just for academic reference. Hence, the same is not dealt by the author in detail.

2. **Section 16 of CGST Act**

   Eligibility and conditions for taking Input Tax Credit

   Having negated Section 43A, it would be worth analysing if there is any other section under GST Act which has the power to impose restriction on claiming ITC. In this regard, Section 16(1) of CGST Act is highlighted hereunder:

   "(1) Every registered person shall, ***subject to such conditions and restrictions as may be prescribed*** *and in the manner specified in section 49, be entitled to take credit of input tax charged on any supply of goods or services or both to him which are used or intended to be used in the course or furtherance of his business and the said amount shall be credited to the electronic credit ledger of such person."*

The Supreme Court under erstwhile laws has time and again stated that ITC is not a vested right or a dealer's right but a concession given by the legislature. With this background, Section 16 has been laid down under GST. Section 16 is the primary section which grants the benefit of ITC to a taxpayer on fulfilment of certain conditions. The sub-section (1) clearly provides for imposing of conditions and restrictions on ITC by the legislature. Therefore, one may conclude that GST Act has powers to provide for restrictions on the ITC. However, fundamental debate may be required as till what extent the restrictions may be imposed. Can any and every restriction under the sun be imposed on the taxpayer in guise of Section 16(1) of CGST Act?

Judicial precedents

The Courts from time-to-time have duly held that ITC is not a vested right. However, it is well-established while imposing conditions to the concession, the same should in no way violate the fundamental rights of the taxpayer entrusted by the Constitution. Conditions on ITC within the framework of Constitution may be held to be legal and binding.

Violation of Article 14 of Constitution

Recently Supreme Court had upheld the judgment of Delhi High Court in case of **Arise India Limited,** pertaining to Delhi VAT Laws. The High Court had held that Input Tax Credit cannot be denied to recipient on default of payment by supplier. In the captioned case, the seller had not paid output tax to the DVAT authorities and accordingly purchaser was denied ITC, in spite of there being no mismatch in 2A-2B return annexures.

Accordingly, the Court pronounced that in absence of mismatch, the ITC cannot be denied to the genuine purchaser. *Inter alia*, the Hon'ble Court had made a very interesting remark on Article 14 of the Constitution, which is as under:

The violation of Article 14 was upheld by the Hon'ble High Court because the provisions treated both the innocent purchasers and the guilty purchasers alike. In other words, it is submitted that by treating unequals equally, the

legislative measure is violative of Article 14 of the Constitution. The relevant extract from the said judgment is reproduced hereunder for reference:

"While denial of ITC could be justified where the purchasing dealer has acted without due diligence, i.e., by proceeding with the transaction without first ascertaining if the selling dealer is a registered dealer having a valid registration, denial of ***ITC to a purchasing dealer who has taken all the necessary precautions fails to distinguish such a diligent purchasing dealer from the one that has not acted bona fide.*** *This failure to distinguish bona fide purchasing dealers from those that are not, results in Section 9(2)(g) applying equally to both the classes of purchasing dealers.* ***This would certainly be hit by Article 14 of the Constitution as explained in several decisions which will be discussed hereinafter."***

This argument may be of much relevance while applying Rule 36(4), since rule 36(4) casts unjust disallowance in certain cases for e.g., purchases from quarterly filers. In such cases tax has been duly discharged on a monthly basis but facility to upload GSTR-1 has been prescribed as quarterly. In such cases, a genuine purchaser (purchasing goods from quarterly dealer) is being disallowed the ITC as per interplay of Rule 36(4) in the month of purchase. This makes no distinction between a genuine purchaser purchasing goods from a quarterly dealer and a guilty purchaser. Accordingly, a view may be formed that for certain situations, Rule 36(4) is violative of fundamental rights conferred by the Constitution.

The said Rule 36(4) has already been challenged before Hon'ble Gujarat High Court by the Society of Tax Analysis and Research and next hearing is scheduled on 18-12-2019.

Issues arising out of Rule 36(4)

While above may be few of the arguments that will eventually roll in the rooms of courts. However as on date, the fact cannot be denied that Rule 36(4) is a reality and not been struck down by any of the courts. Hence, the author would like to discuss few issues arising out of application of said sub-rule 36.

1. *Some of the credits do not appear in GSTR-2A such as import of goods, reverse charge. How to claim ITC on the same?*

   The above issue has been clarified positively by way of Circular No. 123 dt 11-11-2019 and it has been stated that restriction as per Rule 36(4) will not apply in such cases.

2. *A particular expense has been booked by an entity in the month later than what the vendor has shown in GSTR 2A. Accordingly, there will be deficit in GSTR 2A in the month in which ITC is claimed.*

   The Rule is silent as to matching should be with regard to which particular month. Further, in absence of any clarification, one will have to undertake consolidated reconciliation of GSTR-2A and GSTR-3B for all the months from start of financial year.

3. *GSTR-2A being dynamic report is getting updated daily and accordingly which date GSTR-2A should be downloaded if reconciliation is to be undertaken?*

   The Circular states that GSTR-2A as on due date of GSTR-1 needs to be considered. However, under the GST Rules, the ITC is being claimed by way of credit in electronic credit ledger on filing of GSTR-3B. Accordingly in view of the author, GSTR-2A as on date of filing of GSTR-3B may be considered.

4. *If GSTR-2A is significantly lower than ITC as per GSTR-3B, what should be done?*

Till the time matter reaches further clarity, it is advisable to strongly pursue the non-filers and request them to file GSTR-1 at the earliest. Once GSTR-1 is filed by the non-filers, credit may be safely availed in GSTR-3B. One may choose to delay filing of GSTR-3B rather than risking ITC due to non-filers. Needless to say that late filing fees and interest exposure may come into play.

5. *A person has purchased goods from quarterly dealers and therefore same is not appearing in GSTR-2A. Whether ITC on such transaction will not be available?*

   The time limit for filing of GSTR-1 for few dealers has been delayed by the government. However, Rule 36(4) has full cognizance to this reality and thereafter provided ITC restriction, on the details of which have not been uploaded by the suppliers under GSTR-1. Thus, on a strict interpretation of the rule, ITC restriction may continue to apply as long as GSTR-1 is filed by al the dealers. However, this cannot be the intention of the legislature at any given time and chances of positive clarification on the said issue cannot be ruled out.

6. *Section 16(2)(3) states a condition that ITC will be available only if tax has been duly paid by the vendor. Accordingly, if ITC is appearing in GSTR-2A but taxpayer is uncertain as to whether he has discharged tax in GSTR-3B or not. In such cases, how to claim ITC?*

   The high court decision in case of *Arise India (supra)* was delivered on a similar footing. Thus, it is nearly impossible for a person to check as to whether the vendor whose ITC is matched in GSTR-2A, has actually filed GSTR-3B and if GSTR-3B is filed, whether the same is correct or not. In view of the author, the department has to administer the said process of mismatch between GSTR-1 and GSTR-3B and accordingly initiate recovery proceedings under GST law on the defaulting vendor.

The above are very few examples of issues arising out of Rule 36(4) and author has tried to summarise the same in a gist.

Conclusion

While the above sub-rule may impose impossibility, blocking of working capital, the intention of the lawmakers appears to improve the compliance level and validation of ITC. The non-filers need to get in line and if rightly pushed by their own customers, we can expect a healthy state of GST compliances. Therefore, the said rule should be interpreted in its right spirit and essence. The bureaucrats should look at substance over form and unless *mens rea* is proved, one should refrain from imposing penalties or denial of a substantive right under the law.

❍❑❍

If money helps a man to do good to others, it is of some value; but if not, it is simply a mass of evil, and the sooner it is got rid of, the better.

– Swami Vivekananda

INDIRECT TAXES

CA Naresh Sheth & CA Jinesh Shah

GST – Recent Judgments and Advance Rulings

A. Ruling by Appellate Authority for Advance Ruling

1. ARIHANT ENTERPRISES – AAAR MAHARASHTRA (2019-TIOL-69-AAAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is a partnership firm engaged in the business of reselling ice creams in wholesale as well as retail sale packages. Applicant purchases ice cream from its sole manufacturer M/s. Kamaths Ourtimes Ice-creams Pvt. Ltd. (the Franchisor) and sells the ice creams "as it is" without any further processing/alteration/structural or chemical change. Applicant purchases ice cream in retail and wholesale packs from the franchisor under a tax invoice having GST @ 18%.

Applicant had sought advance ruling on the following questions –

a. *Whether supply of ice-cream by the applicant from its retail outlets would be treated as supply of 'goods' or supply of 'services' or a 'composite supply' and subject to GST accordingly?*

b. *Whether the supply not being a composite supply, would be treated as supply of service in terms of entry 6(b) of Schedule II of the CGST Act, 2017 and leviable to CGST @2.5% in terms of N/N. 11/2017 as amended by N/N. 46/2017- Central Tax (Rate)?*

c. *In case the supply is held to be 'composite supply', whether the taxability of the same should be treated as supply of service in terms of entry 6(b) of Schedule II of the Act or should be taxable on the basis of nature of principal supply u/s. 8 of the Act?*

d. *In case the supply is held to be a supply of service as per entry 6(b) of Schedule II of the Act, would it be mandatory to collect and pay CGST @ 2.5% in terms of N/N. 11/2017?*

Applicant's submission

Section 2(30) of Act defines "Composite Supply" to *mean a supply made by a taxable person consisting of two or more taxable supplies of goods or services or both, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply.* There is no objection to the fact that the transaction under consideration involves transfer of movable goods. The customers agree to purchase the above-mentioned final products from the applicant. There is no contract for provision of any service. The customers are free to consume the ice creams inside or outside the outlet. This contention is supported by the fact that none of the outlet provides the facility of serving/dining to the customers.

It is clear that there is only one activity, which has taken place predominantly i.e. buying and selling of ice creams. Applicant does not intend to provide any sort of service to their consumers. Selling the scoop of ice cream into the cups and cones is merely an ancillary or incidental supply. The same cannot be treated as a predominant nature of the transaction. Thus, the predominant nature of the transaction is that of supply of goods.

Discussions by and observations of AAR

AAR noted the contention of applicant that the space (chair-tables) for consuming the ice cream is made for the convenience of the customers and the dominant object involved is sale of ice cream. The decision of Rajasthan High Court in case of ***Govind Ram and Ors vs. State of Rajasthan*** is squarely applicable to this case. Applicant's outlet differ from the conventional restaurants. Even if said transaction is considered as a composite supply u/s. 2(30) of the Act, the principal supply is sale of goods i.e., ice cream, being the predominant element of the transaction.

AAR further observed that there is a transfer of title in ice creams from the applicant to their customers and therefore as per entry no. 1(a) of the Schedule II of the Act, the subject transaction is nothing but a supply of goods.

In nutshell, AAR held that supply of ice cream by applicant from its retail outlets would be treated as *'Supply of Goods'*.

Appeal to the AAAR

Being aggrieved, the department filed the appeal against the above referred advance ruling. It contended that respondent had suppressed certain vital facts in the application made before the AAR about the investigations initiated by the DGCI against M/s. Kamaths Ourtimes Ice Creams Pvt. Ltd. (hereinafter referred as 'KOTI') and its various franchisees who deal in Natural brand ice cream under the terms and conditions of an identical franchisee agreement.

Appellant's submissions

The Appellant submitted that the DGCI intimated them that Arihant Enterprises has suppressed vital facts in the application made before the AAR. The DGCI had initiated investigations against M/s. Kamath Ourtimes Ice Creams ('the Franchisor') and its various franchisees.

Investigations appear to reveal that GST of more than ₹ 40 crores have been evaded by:

- Misclassification of the activity as supply of goods under HSN 2105 instead of correct classification as supply of service under SAC 9963;
- Suppression of supplies made and GST evaded thereon.

DGCI was not a party to the AAR order and was unaware of the proceedings.

Discussions by and observations of AAAR

The AAAR observed section 98(2) of the Act which states that the application shall not be admitted where the question raised in the application is already pending in the case of an applicant under any of the provisions of this Act. The term 'any of the provisions of this Act' includes investigation proceedings under Section 67. Thus, it is clear that the DGCI proceedings were pending at the time of AAR order.

In addition, the franchisee operates under the tight control of the franchisor and it may be reasonable to assume that the taxation followed by Arihant Enterprises is also controlled by KOTI. The statements of one of the partner of Arihant Enterprises brings out the fact that there were oral discussions with the directors of KOTI regarding filing of an advance ruling in respect of whether the activity of 'sale of ice-cream from natural outlets' to be classified as 'supply of goods 'or 'supply of service'.

Further, as per section 104 of the CGST Act, 2017, power has been given to the Appellate Authority to declare an order under section 98(4)

to be void *ab-initio* in case it is obtained by fraud or suppression of material facts. The jurisdictional officer has a valid reason to be aggrieved by the order of the AAR and therefore there is no incongruity in him filing an appeal before the Appellate Authority.

The Appellate Authority further observed a Supreme Court judgment in the case of ***'S.P. Chengalvaraya Naidu (Dead) vs. Jagannath (Dead) (1993) Supp. 3 SCR 422'*** wherein it was held that *it is a settled proposition of law that a judgement or decree obtained by playing fraud on the court is a nullity and non-est in the eyes of law.*

Order of AAAR

In view of above discussion, the instant appeal is allowed and the order passed by the AAR is declared void *ab initio*, as it was vitiated by the process of suppression of facts.

B. Rulings by Authority for Advance Ruling

2. M/S. SANTOSH DISTRIBUTORS – AAR KERALA (2019-TIOL-433-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is an authorized distributor of M/s. Castrol India Ltd., Mumbai (Principal Company) for the supply of Castrol brand industrial and automotive lubricants. There is a written agreement between principal and applicant for distributorship. The principal company is controlling and managing entire marketing activities of their products. The principal company is having various rate scheme with dealers. The distributors are required to use principal company's software for making further supply of products.

The distributors have to follow the principal company's prices as they are the sole controller of the billing software and the prices of the products. Principal company issues an invoice to its distributors and the distributors supplying the goods to the dealers issue invoice based on the various rate scheme pre-fixed by the Principal Company. While the distributor generates invoice to dealers through the software designed by the principal company, the invoice value of the products will be displayed only with the value after deducting discount as per the pre-fixed rate scheme. The distributors are bound to supply the products to the respective dealers as per value shown in the invoice. The discount/ rebate given by the distributor to the dealers will be subsequently reimbursed by the principal company as commercial credit notes.

Applicant has thus sought advance ruling on the following –

a. *The applicant is paying the tax due as per the invoice issued and availing the input credit of GST shown in the inward invoice received from the principal company or their stockiest. What will be the tax liability for these transactions?*

b. *Whether the discount provided by the principal company to their dealers through the applicant attracts any tax under GST?*

c. *Whether the amount shown in the commercial credit note issued to the applicant by the Principal Company attracts proportionate reversal of ITC?*

d. *Whether any tax liability arises for the amount received as reimbursement of discount or rebate provided by the principal company as per written agreement between the principal company and their dealers?*

Discussions by and observations of AAR

The authority observed that discount provided by the applicant is subsequently reimbursed by the Principal company by means of Commercial Credit Notes.

The authority further observed section 15 of the CGST Act wherein the deductions of discounts

from the value of taxable supply is subject to the conditions prescribed in Section 15(3). In present case, the principal company is issuing commercial credit notes for reimbursement of discount provided by the applicant to the customer as per instructions of the supplier. Since the commercial credit notes issued by the principal company do not satisfy the conditions prescribed in Section 15(3), the supplier is not eligible to reduce the original tax liability.

As the supplier of the goods is not reducing the original tax liability, the applicant will be eligible to avail the full input tax credit of the tax paid on supplier's invoice. In other words, the applicant will not be required to reverse the proportionate input tax credit.

The discounts offered to customers by the applicant are completely reimbursed by the principal company. The additional discount/reimbursed amount represents the consideration flowing from the principal company to the applicant for the supply made by the applicant to the customers. The additional discount/reimbursed amount is, therefore, liable to be added to the c**onsideration payable by the customer** to the applicant for arriving at value of supply. Further, the customer if registered, would only be eligible to claim ITC of the tax charged by the applicant **only to the extent of the tax paid by the said custome**r to the applicant as per second proviso to section 16(2) of the CGST Act, 2017.

Ruling of AAR

In respect of question (a), the applicant/distributor is eligible to avail ITC shown in the inward invoice received from the supplier of goods (principal company).

In respect of question (b), the Additional discount reimbursed by the principal company to the distributor/applicant is to be added to arrive at value of supply u/s. 15 of the CGST Act in the hands of the applicant.

In respect of question (c), the principal company issuing the commercial credit note is not eligible to reduce his original tax liability and hence the applicant will not be liable to reverse the ITC attributable to the commercial credit notes received from the supplier.

In respect of question (d), the applicant is liable to pay GST at the applicable rate on the amount received as reimbursement of discount/rebate from the principal company.

3. M/S. PRESTIGE SOUTH RIDGE APARTMENT OWNERS' ASSOCIATION – AAR KARNATAKA (2019-TIOL-343-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is an Apartment Owners' Association, registered under Karnataka Apartment Ownership Act, 1972 and is engaged in providing maintenance and repairs of the common area of the apartments and surrounding areas. It collects contributions from its members based on super built-up area owned. It also separately collects contribution towards corpus fund for future contingencies. The applicant procures goods and services from third party vendors for maintenance of the apartments and charges the maintenance charges on its members. The inputs and input services include –

- Security services
- Housekeeping materials
- Landscaping services
- Repairs and maintenance of various assets
- Pest Control services, etc.

Based on area of occupancy, some of the members pay more than ₹ 7,500/- per month and members of few units pay less than ₹ 7,500 per month towards maintenance charges. Maintenance charges are collected quarterly. With respect to electricity charges, separate electricity

meters are installed for individual flats and each of units directly pay to the Electricity Supply Corporations. The applicant pays electricity charges for power consumed towards common area and recovers such amount from members by raising debit notes.

Applicant has sought advance ruling on the following questions:

a. *Whether the activity of procuring Goods and Services from third parties for upkeep and maintenance of Apartments and collecting the monies from members to pay third party vendors is an activity liable to GST?*

b. *If liable to GST, whether the exemption entry No. 77 of Notification 12/2017-Central Tax (Rate) dated 28-6-2017 apply for maintenance charges collected?*

c. *If exemption is available, whether it is available on per member basis or per flat basis, as some members could have more than one flat?*

d. *Whether the exemption as per entry no. 77 of Notification No. 12/2017-Central Tax (Rate) is a standard exemption that can be claimed irrespective of amount collected towards maintenance?*

e. *Whether the electricity charges paid to Electricity supply authority towards common facilities and separately recovered from members, liable to GST?*

f. *Whether the Corpus/Sinking fund collected from members liable to GST?"*

Discussions by and observations of AAR

While discussing the **question (a),** the authority observed that the applicant is a registered entity separate from its members and has separate legal existence. As per section 2(17) of the CGST Act, 2017, the term 'business' includes the provision, by a club, association, society, or any such body (for a subscription or any other consideration) of the facilities or benefits to its members. The activities of the society fall under the scope of section 7(1) of the CGST Act, 2017 i.e. "Supply". Thus, the applicant is supplying the services of maintenance of the common areas including repairs and upkeep in the course or furtherance of business.

While discussing the **question (b),** the authority observed following:

- Applicant is registered under Karnataka Apartment Owners' Association Act, 1972.
- Applicant provides services only to its members and collects the share of contribution or reimbursement of charges.
- Recipients of services provided by the applicant are its own members.

In view of above, the exemption under entry No. 77 of Notification No. 12/2017-Central Tax (Rate) dated 28-6-2017 as amended by Notification No. 2/2018-Central Tax (Rate) dated 25-1-2018 is available up to ₹ 7,500/- p.m. per member, collected for sourcing of goods or services from a third person for common use of the members.

While discussing the **question (c),** the authority referred to Circular No. 109/28/2019-GST dated 22-7-2019 wherein the exemption is applicable to eligible members on per flat basis.

While discussing the **question (d),** the authority referred to Circular No. 109/28/2019-GST dated 22-7-2019 at para 1, issue 5 and the same reads as:

"The exemption from GST on maintenance charges charged by a Resident Welfare Association (RWA) from resident is available only if such charges do not exceed ₹ 7,500/- per month per member. In case the charges exceed ₹ 7,500/- per month per member, the entire amount is taxable."

While discussing the **question (e),** the authority observed that the applicant paid electricity charges and recovered the amount from members for the electric power consumed towards lighting of common areas. Further, they propose to recover the actual charges paid to Electric Suppliers in respect of the power consumption for

common area, from the members proportionate to the carpet area owned by them, by raising a debit note indicating the proportionate electricity charges. Though the electricity bill is distributed to all its members, it is not the consideration for the supply of electrical energy to the members but the value is a part of the consideration for the supply of services to its members and hence is liable to tax at appropriate rates.

Hence, the value of electricity charges shown separately in the invoices is to be added to the considerations shown towards the same service of upkeep and maintenance charged to individual members and then the consideration for the supply of such service is to be arrived and the taxable value shall be determined.

While discussing the **question (f),** the authority observed that the corpus fund or sinking fund is mandatory under the bye-laws of the Co-operative Societies/Residential Welfare Associations and is in the nature of a deposit towards unforeseen events or planned events. As per proviso to section 2(31) of the CGST Act, 2017 a deposit given in respect of the supply of goods or services or both shall not be considered as payment made for such supply unless the supplier supplies such deposit as consideration for the said supply. Thus, the proviso states that the deposit given in respect of a future supply shall not be considered as payment made for such supply until the supplier applies such deposit as consideration.

Ruling of AAR

In respect of question (a), the activity of procuring goods and services from third parties for upkeep and maintenance of apartments and collecting the monies from its members to pay third parties is an activity liable to GST.

In respect of question (b), the exemption of ₹ 7,500/- in terms of entry No. 77 of Notification No. 12/2017-Central Tax (Rate) dated 28-6-2017, as amended, is applicable for maintenance charges collected from members.

In respect of question (c), the benefit of exemption up to ₹ 7,500/- is applicable on per flat basis, when members have more than one flat.

In respect of question (d), if the maintenance charges exceed ₹ 7,500/- per month per member, the entire amount is taxable.

In respect of question (e), electricity charges paid to the Electricity supply authority for power consumed towards common facilities and separately recovered from members is liable to GST as consideration received for the supply of maintenance services.

In respect of question (f), the Corpus fund or Sinking fund collected from members is not liable to GST as it amounts to deposits received towards future supply of services.

4. M/S. VISTA MARINE AND HYDRAULICS – AAR KERALA (2019-TIOL-431-AAR-GST)

Facts, Issue involved and Query of the Applicant

The applicant is engaged in the business of rendering repairing service of boats/vessels along with supply of spare parts and accessories. The applicant has entered into a Repair Rate Contract with customer (Naval Ship Repair Yard, Kochi), to provide service, *viz.*, repairing of boats as per the rate mentioned in repair rate contract and to supply the spares/accessories at the rate mentioned.

Applicant has sought advance ruling for the following issue

*Whether the supply of spare parts/accessories and repair service can be considered as **composite supply** wherein the principal supply is repair service and hence rate of tax for all the supplies, consisting of spare parts/accessories and repair service, be taken 18%?*

Discussions by and observations of AAR

The applicant is an authorized dealer of Volvo Penta, a division of Volvo Group India (P) Ltd. Whenever there is a requirement to repair Volvo Penta engine installed boats, the customer shall raise a Repair Work Order specifying details of spare parts to be supplied along with price, service to be rendered along with rate, etc., as per Repair Rate Contract. On completion of work, the applicant shall raise invoice indicating separately value of various spare parts and service charges.

Supply of spare parts includes items taxable at 28% and 18%, whereas the rate of tax on repair service is 18%. The applicant is of the contention that the repair service of boats along with supply of necessary spare parts and accessories is a composite supply wherein the principal supply is supply of repair service and thereby attracts 18% GST.

Repair Rate contract is a contract containing rate for various repair services and supply of spares/ accessories given to customer. The contract is signed for the period of three years and revised price list of spares is submitted after completion of each year. The upward revision will not exceed 6% with respect to previous year's price. The Repair rate contract provides for revision of rate of supply of spares and repair services also separately.

In rate contract, there is a fall clause which provides price safety mechanism. It provides that if during the tenure of the contract, the applicant sells the contracted goods at a reduced price, the rate contract price will be automatically reduced with effect from that date for all the subsequent supplies under the rate contract.

From the above, it is evident that in the Repair Rate Contract, the supply of spares parts and repair service are distinct and separately identifiable supplies for which rates are quoted differently. The applicant is also issuing invoices separately indicating the value of spares/ accessories and the service charges.

Considering the above fall clause and the fact of issuing work order separately for spares/ accessories separately, the activity of applicant is covered by para 2.2 of CBIC circular No. 47/21/2018-GST dated 08.06.2018 wherein it is clarified that where a supply involves supply of both goods and services and values for both are separately shown, the goods and services would be taxable at tax rates as applicable to goods or services separately.

Ruling of AAR

AAR ruled that goods and services in said Repair rate contract would be liable to tax at the rates as applicable the goods and services separately.

5. WEWORK INDIA MANAGEMENT PRIVATE LIMITED – AAR KARNATAKA (2019-TIOL-416-AAR-GST)

Facts, Issue involved and Query of the Applicant

Applicant is engaged in the business of supplying shared workspace/office space for which it procures goods and services from various contractors for fitting out of workspaces. Then, it provides the said workspace on rent to various companies/individuals as sharing workspaces.

Applicant has sought advance ruling on following questions:

a. *Whether input tax credit can be availed by the applicant on the detachable 14mm Engineered Wood with Oak top Wooden flooring which is movable in nature and capitalized as "Furniture and Fixtures", and is not capitalized as Immovable Property?*

b. *Whether input tax credit can be availed by the applicant on the detachable sliding and stacking glass partition which is movable in nature and capitalized as "furniture and fixtures", and is not capitalized as an immovable property?*

Applicant's submissions

The applicant stated that as per Section 17(5)(d) of the CGST Act, a restriction is imposed with respect to input tax credit on procurement of goods and services or both received by the taxable person for construction of an immovable property (other than plant and machinery). The term **'construction'** is limited to the supplies to the extent it capitalized to an immovable property and includes **re-construction, renovation, additions, alterations or repairs.**

The term **'plant and machinery'** means **'apparatus, equipment, and machinery fixed to Earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural support but excludes: (a) land, building or any other civil structures; (b) telecommunication towers and (c) pipelines laid outside the factory premises.** Hence credit is restricted so far as inputs/input services are used for construction of an immovable property.

The detachable 14mm engineered wood with Oak top wooden flooring are not inextricably linked to the construction itself but are only an addition added above the flooring already present in the fully constructed building which can be detached and re-used hence they are not capitalised as immovable property rather recorded as 'furniture and fixtures' and thus not blocked under Section 17(5)(d) of CGST Act, 2017.

The applicant submitted that it is eligible to avail credit on the detachable sliding and stacking glass partitions as the same are being fitted in the building for the coworking space being let out to its members thus getting used in the course or furtherance of business. They are being capitalized in the books of account as **'Furniture and Fixtures'** instead of immovable property and a chartered accountant certificate was also submitted.

Applicant also submitted that anything embedded to the Earth which cannot be dismantled and moved, are covered under the ambit of **"immovable property"**. The term Immovable property has been referred from the General Clauses Act 1897 and Transfer of Property Act 1882 whereas the term **"attached to the Earth"** can be defined as anything that is **(a) rooted to the Earth, as in case of trees and shrubs; (b) imbedded in the Earth, as in the case of walls and buildings; (c) attached to what is so imbedded for the permanent beneficial enjoyment of that to which it is attached.**

Applicant also emphasized that:

- Detachable engineered wood is fixed using the stripped foam; and
- Detachable sliding and stacking glass partitions is fixed with the help of nuts and bolts to a foundation intended to provide stability to the working.

Therefore, both would not fall under ambit of "Anything attached to Earth" and thus they are neither rooted to the Earth nor embedded in it as the same is detachable and reusable.

Applicant further stated that one of the types of wooden flooring which is **glued down** cannot be re-used after getting dismantled and the detachable 14mm engineered wood, which is inter-locked by using a polished strip foam, is re-usable and can be removed without damaging the area. It also submitted that in the process of fitting the detachable glass partitions, an aluminium store front is fixed to the structure with the help of nuts and bolts and to the same, the glass is attached. Hence, based on the above submissions it becomes evident that detachable sliding and stacking glass partitions qualify as **"movable property"** since the same can be dismantled and re-used and hence become eligible for input tax credit.

Applicant also referred to the advance ruling in the case of M/s. VINDHYA TELELINKS LTD. It also placed reliance on the advance ruling of M/s. BAHL Paper Mills Ltd. where the question was whether credit would be admissible on office

furniture and fixtures, AC, plant and sanitary fittings on the newly constructed building on its own account, thereafter it was concluded that credit was allowed in respect of office furniture and fixtures, AC but wasn't available on sanitary fittings, it being a part of the land (*Explanation* to Section 17 of CGST Act). Further, it relied on the judgement of ***M/s. Balkrishna Industries Ltd vs. CCE, Jaipur-1*** and advance ruling in case of Nipro India Corporation Private Limited etc.

Discussions by and observations of AAR

AAR observed that Section 17(5) overrides section 16(1) and any input tax credit shall not be available in respect of c**onstruction services procured for** an immovable property (other than plant and machinery) except provided otherwise.

The term "construction" includes additions to immovable property to the extent of capitalization. However, certificate of the Chartered Accountant shows that the additions are capitalized in the books under the Fixed Assets Head "Furniture and fixtures" and it is nowhere stated that the capitalized amount needs to be declared as in the books within the value of immovable property i.e. buildings. **The Accounting Standards which enumerate the classes of fixed assets being land and buildings, furniture and fixtures does not classify property as movable and immovable** and hence an asset classified as fixture could still be an immovable property. **Mere declaration of the same under different class of Fixed Assets does not change its nature being an immovable property.**

AAR observed that definition of immovable property under General Clauses Act, 1897, is an inclusive definition and includes anything attached to earth or permanently fastened to anything attached to earth. It also noted that the office space provided is an immovable property. The character of office space is of certain degree of permanence so that the office space of one tenant can be distinguished from another.

Sliding partitions are fixed to the building to create the office spaces and hence is *"sine qua non"* for letting out of office space. There cannot be office space unless these are fixed and hence it is said to be permanently fastened to the building. Hence the fixing of sliding partitions amounts to addition or alteration to an immovable property and input tax credit shall not be eligible.

With respect to fixing of 14mm Engineered wood with Oak top wooden flooring, applicant stated that wood used for flooring is attached by using a foam called polished strip foam and at ground level, a cementious bare panel is erected using pedestals and thereafter, foam is used to lay the wood. The wooden flooring can be easily detached and reused and only adds to the value of the building hence it is not *"sine qua non"* for the office space unlike the partitions. The wooden flooring can be removed and replaced without affecting office space.

There is no permanence involved in the fastening nor any damage is done to the property, either to the building or to the wooden flooring at the time of detachment of flooring.

Ruling of AAR

In respect of question (a), the input tax credit can be availed on the detachable 14mm Engineered wood with Oak top wooden flooring which is movable in nature and capitalized as "furniture".

In respect of question (b), the input tax credit is not available on the detachable sliding and stacking glass partitions.

6. M/S. EMRALD HEIGHTS INTERNATIONAL SCHOOL – AAR MADHYAPRADESH (2019-TIOL-300-AAR-GST)

Facts, Issue involved and Query of the Applicant

Emerald Heights School Samiti (Applicant) is a registered Society under M.P. Societies Act, 1971 engaged in promotion of education. It owns and

runs 'The Emerald Heights International School'. Applicant is not registered under GST as it provides educational services. The school is also affiliated and associated with various National and International organizations, which aim to promote education and sports worldwide. One such organization is 'Round Square' [charitable organization in England]. The association organizes conferences for Students and staff of its Member School. As applicant is one of the member of the organization, they intend to hold one such educational conference/gathering in Indore, India.

Applicant and the Association intend to enter into an agreement for hosting and managing the conference/gathering. The proposed agreement clearly mentions that applicant shall act as Host of the conference in its own right and shall not be deemed to be acting as an agent of the Association. Applicant is responsible for planning the conference, inviting the participants, arranging the accommodation and food, organizing and managing the events in the conference, etc. Consideration shall flow from the other member schools in form of fees along with list of individual student and staff attendees. No surplus is expected to be generated from the conference.

Applicant has sought advance ruling on the following questions:

a. *Whether the consideration received by the school from the participant schools for participation in the conference be exempted under entry no. 66 or entry no. 1 or entry no. 80 or any other entry of the Notification No. 12/2017 – Central Tax (Rate)? If not, whether it will be chargeable to GST under CGST Act, 2017 and MPGST Act, 2017 or IGST Act, 2017?*

b. *If not exempted then what would be the appropriate category of the service and the appropriate tax rate?*

c. *What would be the place of supply for such service?*

d. *Whether exemption provided to service providers of catering, security, cleaning, housekeeping, transportation, etc. to an educational institution up to higher secondary be available to the Service Providers of the Appellant for services related to such conference?*

e. *Whether ITC would be eligible of all the input services availed for the purpose of the above conference?*

Discussions by and observations of AAR

AAR examined applicability of exemption entries mentioned in N/N. 12/2017-Central Tax (rate) dated 28-6-2017 as under:

Entry No.	***Activity***	***Applicability***
1	Services provided by an entity registered u/s.. 12AA of the Income Tax Act, 1961 by way of charitable activities.	Not applicable as applicant is not a registered entity u/s. 12AA of the Income-tax Act, 1961 for charitable activities.
80(a)	Services by way of training or coaching in recreational activities relating to arts or culture.	Activities of holding conference/gathering of students, faculty and staff of other schools cannot be said to be training in recreational activities relating to arts and culture.
80(b)	Services by way of training or coaching in recreational activities relating to sports by charitable entities registered u/s. 12AA of Income-tax Act, 1961.	Not applicable to the applicant.

Entry No.	*Activity*	*Applicability*
66(a)	Services provided by the educational institute to its students, faculty and staff.	Activities of holding educational conference/gathering of students, faculty and staff of other schools cannot be treated as services provided by an educational institution to its student, faculty or staff.
66(aa)	Services relating to conduct of entrance examination.	Not applicable to the applicant.
66(b)(i)	Transportation services for students, staff and faculty provided to educational institution	This clause is not applicable to holding of educational conference/gathering of students/staff of other schools. This is also because such other school may or may not be providing educational services for pre-school education or education up to higher secondary school or equivalent.
66(b)(ii)	Catering services provided to educational institution	This clause is not applicable for catering services provided to educational institution for holding of educational conference/gathering of students or staff of other school because activity of organizing such conference/gathering itself is not exempted under N/N. 12/2017 – Central tax (rate).

Various services provided for organizing an education conference/gathering of students and staff of other schools shall be liable to tax at applicable rates. For example, catering services shall be liable to tax @ 5% (without ITC); security/housekeeping services shall be liable to tax @ 18%.

Ruling of AAR

In respect of question (a), consideration received by the school from the participant school will not be exempt.

In respect of question (b), various services provided for organizing the impugned conference/gathering of students and staff of other schools, shall be liable to tax at the applicable rates.

In respect of question (c), AAR did not comment on place of supply.

In respect of question (d), exemption provided to service providers providing catering services, security services, cleaning services, housekeeping services, transportation services, etc. to an educational institution up to higher secondary shall not be available for services provided for the impugned conference.

In respect of question (e), ITC shall not be available on food and catering services. ITC in respect of any other services shall be available as per provisions of the CGST Act.

7. M/S. TARUN REALTORS PRIVATE LIMITED – AAR KARNATAKA (2019-TIOL-411-AAR-GST)

Facts, Issue involved and Query of the Applicant

The applicant is developing a shopping mall – Mantri Arena Mall, which will include a hypermarket, multiplex cinema theatre complex, departmental stores, retail shops and food courts. Applicant is also entering into various lease agreements with their tenants and will be leasing all units at the mall together with the right to use the staircases, common areas and other common facilities.

To undertake development of the said property, the applicant was required to procure numerous goods and avail numerous services including works contract services.

Applicant has sought advance ruling for the following:

Whether taxes paid on procurement of goods and/or services for installation of the following, hereinafter referred to as "installations", are regarded as blocked credits under Section 17(5) of the CGST Act, 2017?

(a) Chillers (b) Air Handling Unit (AHU), (c) Lift, Escalators and Travellator, (d) Water Treatment Plant (WTP), (e) Sewage Treatment Plant (STP), (f) High Speed Diesel Yard (HSD), (g) Mechanical Car Park (MLCP), (h) Indoor/Outdoor Surveillance System (CCTV), (i) D.G. Sets, (j) Transformers, (k) Electrical wiring and fixtures (l) Public Health Engineering (PHE), Fire-fighting and water management pump system.

Applicant's submission

Section 17(5)(d) of the CGST Act, 2017 provides that **no input tax credit** would be available in respect of goods or services received by a taxable person for **construction of an immovable property** (other than Plant or Machinery) on his own account including when such goods or services are used in the course or furtherance of business.

*Explanation to the said section states that **"plant and machinery"** means apparatus, equipment, and machinery fixed to earth by foundation or structural support that are used for making outward supply of goods or services or both and includes such foundation and structural supports but excludes:*

i) land, building or any other civil structures;

ii) telecommunication towers; and

iii) Pipelines laid outside the factory premises.

The applicant was of the view that all the installations would qualify as 'Plant or Machinery' under the CGST Act, 2017 and accordingly taxes paid on procurement of goods or services for construction of such 'Plant or Machinery' would **not be regarded as blocked credits** under Section 17(5) (d) of CGST Act,2017.

The applicant contended that although the phrase **'Plant and Machinery'** is defined under the GST legislation, the phrase **'Plant or Machinery'** has not been defined. It is critical to note that section 17(5) (d) of the CGST Act, 2017 uses the phrase, 'Plant or Machinery', which has not been, defined under the GST laws. Hence, references must be drawn from the dictionary meanings, meanings ascribed to it under other laws, and judicial pronouncements under the allied laws to understand the phrase.

Based on meaning of 'plant' or 'machinery' established through the legal dictionaries and judicial pronouncements, applicant submitted that all the installations qualify as 'plant' or 'machinery'.

Further applicant relied on following judicial pronouncements that permit claim of CENVAT credit on goods or services or both used in fabrication of parts, components, accessories of the plant and machinery.

- *Commissioner of Central Excise & Service Tax vs. India Cements Ltd 2014(310) E.L.T 636(Mad)*
- *Commissioner of Central Excise Jaipur & Service Tax vs. Rajasthan Spinning & Weaving Mils Ltd 2010(255) E.L.T 481(S.C)*

It has been consistently held that parts, components, accessories come into existence before the installation of the machinery and credit of taxes paid on the same cannot be denied even if they become part of immovable property after installation.

Further, these installations are recorded in the books of account under separate heads as per IND AS (i.e. independent of building or civil structure) which is sufficient justification that these installations are distinct from land and building. Hence, the same do not form a part of the exclusion portion of the above referred

Explanation and are accordingly, not excluded from the definition of 'Plant and Machinery'.

Applicant submitted that although the installations are fixed to the building/earth, they qualify as 'Plant' or 'Machinery' under the CGST Act, 2017 and accordingly, the taxes paid on procurement of goods or services for such installations should not be regarded as blocked credits u/s. 17(5)(d) of the Act read with Explanation.

Discussions by and observations of AAR

AAR observed that the applicant is developing a shopping mall, which will be given on rent for enjoyment of tenant and the additional charges are charged for the maintenance.

Section 17(5) states that "Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available in respect of following, namely:

(d) *goods or services or both received by a taxable person for* ***construction of an immovable property*** *(other than Plant or Machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.*

Explanation.– for the purpose of clause (d), the expression "construction" includes reconstruction, renovation, additions or alterations or repairs, to the extent of capitalization, to the said immovable property."

The applicant stated that he procured goods or services for the purpose of additions to the immovable property and has capitalized them in his books. Therefore, same were covered under the expression "construction of immovable property" and hence input tax credit in respect of such construction is not available.

The claim of the applicant that the immovable property is a plant and hence the input tax credit is eligible for them was dismissed by the authority on the ground that the provision of facilities like transformers, sewage treatment plant, Electrical wiring and Fixtures, Surveillance systems, D.G Sets, Lifts, Air Handling Units etc. are *sine qua non* for a commercial mall and hence cannot be considered separate from the building or civil structure. The provision of these are either statutory for a building or defines the nature of the building as a commercial mall. Hence input tax credit on the inward supplies of goods or services involved in the construction of immovable property, which is a civil structure or building, is not available to the applicant, therefore, blocked.

Ruling of AAR

Taxes paid on procurement of goods/or services for installation of the "Installations" as listed in the application are regarded as blocked credits u/s. 17(5) of the CGST Act, 2017.

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Service Tax – Case Law Update

1 ***State of West Bengal & Ors vs. M/s. Calcutta Club Ltd., CCE vs. M/s. Ranchi Club Ltd.***

2019-TIOL-449-SC-ST-LB

Background Facts of the case

The respondent's M/s. CALCUTTA CLUB LTD were issued notice apprising it that it had failed to make payment of sales tax on sale of food and drinks to the permanent members during the quarter ending 30-6-2002. The Kolkata Tribunal opined that it is not eligible to tax under the Act on the ground that the payments made by the permanent members are not considerations and in the case of Members' Clubs the suppliers and the recipients (Permanent Members) are the same persons and there is no exchange of consideration.

The Kolkata HC while dismissing revenue appeal held that the members collectively was the real life and the Club was a superstructure only and, therefore, mere fact of presentation of bills and non-payment thereof consequently, striking off membership of the Club, did not bring the Club within the net of sales tax; that in the obtaining factual matrix the element of mutuality was not obliterated.

The SC. Division Bench 2016-TIOL-79-SC-CT set out the following three questions to be answered by a larger Bench:

(i) Whether the doctrine of mutuality is still applicable to incorporated clubs or any club after the 46th Amendment to Article 366(29-A) of the Constitution of India?

(ii) Whether the judgment of this Court in Young Men's Indian Assn. [***CTO vs. Young Men's Indian Assn. (1970) 1 SCC 462***] still holds the field even after the 46th Amendment of the Constitution of India; and whether the decisions in Cosmopolitan Club [***Cosmopolitan Club vs. State of T.N., (2017) 5 SCC 635***] and ***Fateh Maidan Club (2008) 12 VST 598 (SC)***] which remitted the matter applying the doctrine of mutuality after the Constitutional Amendment can be treated to be stating the correct principle of law?

(iii) Whether the 46th Amendment to the Constitution, by deeming fiction provides that provision of food and beverages by the incorporated clubs to its permanent members constitute sale thereby holding the same to be liable to sales tax?"

Arguments put forth

The appellants (Revenue) submitted as under:

a) Referring to 61st Law Commission Report & the Statement of Objects and Reasons appended to the 46th Amendment to the Constitution, it was stated that Article 366(29-A)(e) was inserted in order to do away with the doctrine of agency/trust or mutuality, insofar as it applied to members' clubs and, therefore, sought to do away with the basis of the judgment in Young Men's Indian Association.

b) The expression "unincorporated association or body of persons" in sub-clause (e) must be read disjunctively, and so read would include incorporated persons such as companies, cooperative societies, etc. Further, even assuming that "body of persons" under 366(29-A)(e) did not include incorporated persons, 366(29-A)(f) would take within its wide sweep the supply of goods, being food or any other article for human consumption or drink, given that sub-clause (f) does not refer to incorporated or unincorporated bodies, and takes within its sweep a tax on the supply of goods "in any other manner whatsoever", which are words of extremely wide import.

c) Relied on ***Deputy Commercial Tax Officer, Saidapet & Anr. vs. Enfield India Ltd., Co-operative Canteen Ltd. (1968) 2 SCR 42***1 for the proposition that the English cases which dealt with the doctrine of mutuality had no application in the context of a taxing statute & to show that profit-motive is totally unnecessary where a supply of goods by a club to its members, falls within the definition of "sale" under the Madras General Sales Tax Act, 1959 in that case.

d) In any case, according to the learned Senior Advocate, the doctrine of mutuality has no application when a members' club is in the corporate form, as it is clear from ***Bacha F. Guzdar vs. Commissioner of Income Tax, Bombay (1955) 1 SCR 876,*** where it was held that a shareholder is not the owner of the assets of a company and, therefore, the aforesaid principle cannot possibly apply to members' clubs in corporate form.

The Respondents (assessee) submitted as under:

a) Referred to Section 2(5) of the West Bengal Sales Tax Act, and stated that the very first pre-requisite for falling within the provisions of that Act is that there should be a profit motive, as defined, and since there is none in members' clubs, the charging section will not be attracted on the facts of these cases. ***State of Gujarat vs. Raipur Manufacturing Co. Ltd. (1967) 1 SCR 618,*** for the proposition that the expression "profit-motive" does not refer to surplus being made, but only refers to a motive of making money from sale transactions.

b) That under no circumstances can a company be fitted within "body of persons", as a result of which Article 366(29-A)(e) will not apply to sales of food or refreshments by a club to its members. 46th Amendment has not done away with the Young Men's Indian Association (supra), as there cannot possibly be a supply of goods by one person to itself; and that, therefore, the doctrine of agency/trust/mutuality continues as before.

c) Referred to the definition of "consideration" in Section 2(d) of the Indian Contract

Act, 1872, which made it clear that consideration must flow from one person to another and in the absence of two players, as in the case of Young Men's Indian Association (supra), Article 366(29-A) would have no application.

d) That 366(29A)(f) was enacted for a very different purpose, namely, to get over the judgment of ***Northern India Caterers (India) Ltd. vs. Lt. Governor of Delhi (1978) 4 SCC 36***, which dealt with the service element contained in a bill for food or drinks being consumed in restaurants. The expression "in any other manner whatsoever" only seeks to re-emphasise that where goods are supplied in such restaurants, then the service element will not interdict the State Legislature from taxing food etc. under Article 366(29-A)(f).

Decision

a) Chapter 1-D of the 61st Law Commission Report was of the view that the Constitution ought not to be amended so as to bring within the tax net members' clubs. It gave three reasons for so doing. First, it stated that the number of such clubs and associations would not be very large; second, taxation of such transactions might discourage the cooperative movement; and third, no serious question of evasion of tax arises as a member of such clubs really takes his own goods.

b) Despite the above report, Article 366(29-A) included within it sub-clause (e). The Statement of Objects and Reasons states that *while sale by a registered club or other association of persons club or association of person having corporate status) to its members is taxable, sales by an unincorporated club or association of persons to its members is not taxable as such club or association, in law, has no separate existence from that of the members.*

c) In ***Graff vs. Evans (1882) 8 Q.B. 373, the Grosvenor Club*** was incorporated in the form of a trust, the appellant Graff acting as Manager of the club, for and on behalf of a Managing Committee, which conducted the general business of the club. Food and refreshments such as wine, beer and spirits were served to members on payment for the same. The Queen's Bench Division held *the true construction of the rules is that the members were the joint owners of the general property in all the goods of the club, and that the trustees were their agents with respect to the general property in the goods, although they had other agents with respect to special properties in some of the goods.*

d) The judgment in Young Men's Indian Association observed that It the club even though a distinct legal entity is only acting as an agent for its members in matters of supply of various preparations to them no sale would be involved as the element of transfer would be completely absent. The case of each club was analogous to that of an agent or mandatory investing his own monies for preparing things for consumption of the principal, and later recouping himself for the expenses incurred. Once this conclusion on the facts relating to each club was reached it was unnecessary for the High Court to have expressed any view with regard to the *vires* of the *Explanations* to Sections 2(g) and 2(n) of the Act. As no transaction of sale was involved there could be no levy of tax under the provisions of the Act on the

supply of refreshments and preparation by each one of the clubs to its members.

e) What is essential is that the holding of the property by the trustee or agent must be a holding for and on behalf of, and not a holding antagonistic to, the members of the club. Young Men's Indian Association (supra) made no distinction between a club in the corporate form and a club by way of a registered society or incorporated by a deed of trust. Proprietary clubs were distinguished, as there the owner of the club would not be the members themselves, but somebody else.

f) That if persons carry on a certain activity in such a way that there is a commonality between contributors of funds and participators in the activity, a complete identity between the two is then established. This identity is not snapped because the surplus that arises from the common fund is not distributed among the members - it is enough that there is a right of disposal over the surplus, and in exercise of that right they may agree that on winding up, the surplus will be transferred to a club or association with similar activities. Most importantly, the surplus that is made does not come back to the members of the club as shareholders of a company in the form of dividends upon their shares. Since the members perform the activities of the club for themselves, the fact that they incorporate a legal entity to do it for them makes no difference.

g) It can be seen that the 61st Law Commission Report had observed that there cannot be said to be any evasion of tax as a member of members' clubs "really takes his own goods" and, therefore, did not seek to tax such goods. The framers of the 46th Amendment thought otherwise, and made it plain that they sought to bring to tax sales made by unincorporated clubs or an association of persons to their members, as it was thought that such transactions were not taxable, as such club or associations in law has no separate existence from that of the members.

h) Quite obviously, the Statement of Objects and Reasons has not read the case of Young Men's Indian Association (supra) in its correct perspective. As has been noticed hereinabove, Young Men's Indian Association (supra) had three separate appeals before it, in one of which a company was involved. To state, therefore, that under the law as it stood on the date of the 46th Amendment, a sale of goods by a club having a corporate status to members is taxable, is wholly incorrect. Proceeding on this incorrect basis, what the 46th Amendment sought to do was to then bring to tax sales by clubs which have no separate existence from that of their members. In so doing, the 46th Amendment used the expression "any unincorporated association or body of persons". This expression, when read with the Statement of Objects and Reasons, makes it clear that it was only clubs which are not in corporate form that were sought to be brought within the tax net, as it was wrongly assumed that sale of goods by members' clubs in the corporate form were taxable.

i) The expression "valuable consideration" has, as has been pointed out in 'Pollock and Mulla, The Indian Contract & Specific Relief Acts (16th ed.), been taken from an old English case ***Currie vs. Misa (1875)***

LR 10 EX 153, and explained as follows: "A valuable consideration in the sense of the law, may consist either in some right, interest, profit, or benefit accruing to one party, or some forbearance, detriment, loss or responsibility given, suffered, or undertaken by the other. The above definition brings out the idea of reciprocity as the distinguishing mark; it is the gratuitous promise that is unenforceable in English law."

j) This is further reinforced by the last part of Article 366(29-A), as under this part, the supply of such goods shall be deemed to be sale of those goods by the person making the supply, and the purchase of those goods by the person to whom such supply is made. Thus, it is clear that the ratio of Young Men's Indian Association (supra) that there cannot be a sale of goods to oneself, has not been done away with by the limited fiction introduced by Article 366(29-A)(e).

k) That the doctrine of mutuality has not been done away with by clause 366(29A)(e) is also clear when sub-clause (e) is contrasted with certain provisions of the Income Tax Act, 1961. Section 2(24)(vii) read with section 44 of the IT Act it is clear that when profits and gains of a mutual insurance company are sought to be brought to tax, they are so done by express reference to the fact that the business of insurance is carried on by a mutual insurance company. The absence of any such language in sub-clause (e) of Article 366(29-A) is also an important pointer to the fact that the doctrine of mutuality cannot be said to have been done away with by the said 46th Amendment. Modalities such as these to bring to tax amounts that would do away with any doctrine of mutuality are conspicuous by their absence in the language of Article 366(29-A)(e).

l) We, therefore, answer the three questions posed by the Division Bench in ***State of West Bengal vs. Calcutta Club Limited (supra)*** as follows:

(1) The doctrine of mutuality continues to be applicable to incorporated and unincorporated members' clubs after the 46th Amendment adding Article 366(29-A) to the Constitution of India.

(2) Young Men's Indian Association (supra) and other judgments which applied this doctrine continue to hold the field even after the 46th Amendment.

(3) Sub-clause (f) of Article 366(29-A) has no application to members' clubs.

m) Examining the above principle of mutuality under Finance Act for applicability of service tax in case of M/s. Ranchi Club Ltd., we accept the argument on behalf of the Respondents that incorporated clubs or associations prior to 1st July, 2012 were not included in the service tax net.

n) Under negative regime, definition of "service" contained in Section 65B(44) is very wide, as meaning any activity carried out by a person for another for consideration. "Person" is defined in Section 65B(37) as including, *inter alia*, a company, a society and every artificial juridical person not falling in any of the preceding sub-clauses, as also any association of persons or body of individuals whether incorporated or not.

o) However, what has been stated in the present judgment so far as sales tax is concerned applies on all fours to service tax; as, if the doctrine of agency, trust and mutuality is to be applied qua members' clubs, there has to be an activity carried out by one person for another for consideration. The fact is that in members' clubs there is no sale by one person to another for consideration, as one cannot sell something to oneself. This would apply on all fours when we are to construe the definition of "service" under Section 65B(44) as well.

p) The explanation 3 to section 65B(44) in *substantially* the same terms as Article 366(29-A)(e) of the Constitution of India. the expression "body of persons" occurring in the explanation to Section 65 and occurring in Section 65(25a) and (25aa) in pre negative regime, does not refer to an incorporated company or an incorporated cooperative society. As the same expression has been used in *Explanation* 3 post-2012 (as opposed to the wide definition of "person" contained in Section 65B(37)), it may be assumed that the legislature has continued with the pre-2012 scheme of not taxing members' clubs when they are in the incorporated form. Thus, *Explanation* 3(a) to Section 65B(44) does not apply to members' clubs which are incorporated.

q) We are also of the view that from 2005 onwards, the Finance Act of 1994 does not purport to levy service tax on members' clubs in the incorporated form.

r) The appeals of the Revenue are, therefore dismissed.

s) In nutshell,

- One person cannot sell goods to itself - provision of food and beverages by the incorporated clubs to its permanent members does not constitute sale – No sales tax.
- From 2005 onwards, the Finance Act of 1994 does not purport to levy service tax on members' clubs in the incorporated form.
- "body of persons" will not include an incorporated company, nor will it include any other form of incorporation including an incorporated co-operative society.
- Legislature has continued with the pre-2012 scheme of not taxing members' clubs when they are in the incorporated form.

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One of the very important characteristics of a student is to question. Let the students ask questions.

– A. P. J. Abdul Kalam

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Kishor Vanjara,
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CA Ketan L. Vajani & CA Haresh P. Kenia,
Hon. Jt. Secretaries

Important events and happenings that took place between 1st November, 2019 to 30th November, 2019 are being reported as under:

I. ADMISSION OF NEW MEMBERS

1) The details of new members who were admitted to the Managing Council Meeting held on 15th November, 2019 are as under:–

Type of Membership	No. of Members
Life Member	11
Ordinary Member	13
Student Member	03

II. PAST PROGRAMMES

1. IT CONNECT COMMITTEE

Workshop on Office Productivity: Technology Tools and Tips was held on 14th November, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churchgate. The workshop was addressed by CA Uday Shah, CA Mayur Jain, and CA Alok Jajodia.

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of December, 2019)

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Hyderabad Study Group

Hyderabad Study Group Meeting on "Case Studies on Transfer Pricing" was held on 2nd November, 2019 at #8–2-120/C//98 /1, Road #2 Banjara Hills, Annapoorna Studio Lane, Hyderabad, Telangana – 500034

CA P. V. S. S. Prasad
addressing the delegates

Pune Study Group

Pune Study Group Meeting on "Speed Reading" was held on 9th November, 2019 at ELTIS, Plot No. 419 Model Colony, Gokhale Cross Road, Next to Atur Centre, Pune – 411 016

CA Srinivas Vakati
addressing the delegates

International Taxation Committee

INT Tax Study Circle meeting on "Tax Treaty Entitlement in view of PPT clause in the MLI" was held on 6th November, 2019 at CTC Conference Room.

CA Sonia Agrawal
addressing the delegates

FEMA Study Circle meeting on "Discussion on Master Direction on Import and Export with Case studies" was held on 8th November, 2019 at CTC Conference Room.

CA Ajit Shah
addressing the delegates

Study Circle & Study Group Committee

Study Circle meeting on "New Scheme of E-Assessment Proceedings" was held on 7th November, 2019 at Babubhai Chinai Hall, IMC, Churchgate.

CA Avinash Rawani
addressing the delegates

Study Group meeting on "Recent Judgments under Direct Taxes" was held on 21st November, 2019 at Babubhai Chinai Hall, IMC, Churchgate.

Mr. Deepak Tralshawala, *Advocate*
addressing the delegates

Membership & Public Relations Committee

SAS Meeting on "Vaastu - The Art of Changing your destiny in Professional Life" was held on 13th November, 2019 at Babubhai Chinai Room, IMC, Churchgate

Mr. Rasesh Shah
addressing the delegates

Commercial & Allied Laws Committee

Allied Laws Study Circle meeting on "Decoding the Ayodhya Verdict – Important Legal principles" was held on 29th November, 2019 at CTC Conference Room.

Mr. Aditya Ajgaonkar, *Advocate*,
addressing the delegates

Bengaluru Study Group

Bengaluru Study Group meeting on "Analysis of Taxation Laws (Amendment) Ordinance, 2019 and E-assessment" was held on 15th November, 2019 at FKCCI, 3rd Floor, Hall No. 4, K. G. Road, Bengaluru – 560009

CA Rishi Harlalka
addressing the delegates

Direct Taxes Committee

ISG on "Recent important decisions under Direct Taxes" was held on 22nd November, 2019 at CTC Conference Room.

CA Kumar Umaji Kale
addressing the delegates

Indirect Taxes Committee

IDT Study Circle meeting on "Issues in interest Penalties and Confiscation of Goods under GST Law" was held on 14th November, 2019 at A. V. Room, Jaihind College, Churchgate

CA Vinod Awtani
addressing the delegates

Mr. Vinay Jain, Advocate,
addressing the delegates

IT Connect

Office Productivity: Technology tools and tips was held on 14th November, 2019 at Babubhai Chinai Hall, 2nd Floor, IMC, Churcgate.

CA Vipul K. Choksi (President) giving his opening remarks. *Seen from L to R:* CA Alok Jajodia (Speaker), CA Maitri Savla (Chairperson), CA Uday Shah (Speaker), CA Mayur Jain (Speaker) and CA Anand Paurana (Convenor)

Faculties

CA Uday Shah addressing the delegates

CA Alok Jajodia addressing the delegates

CA Mayor Jain addressing the delegates

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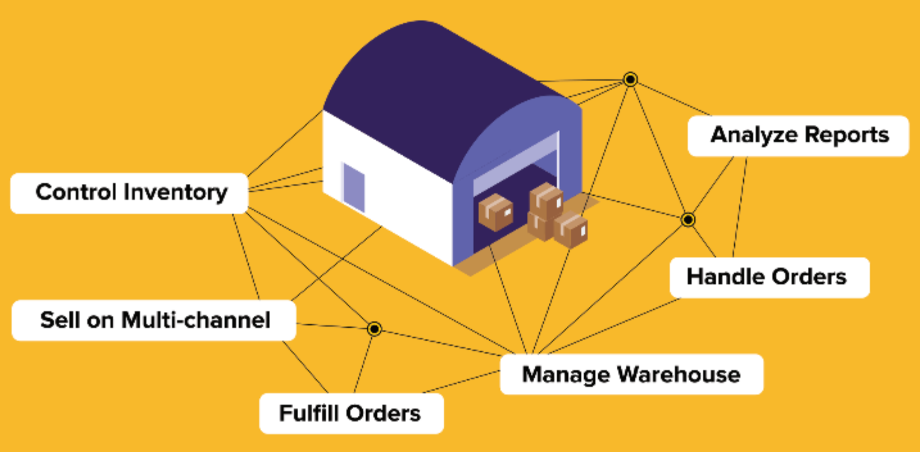

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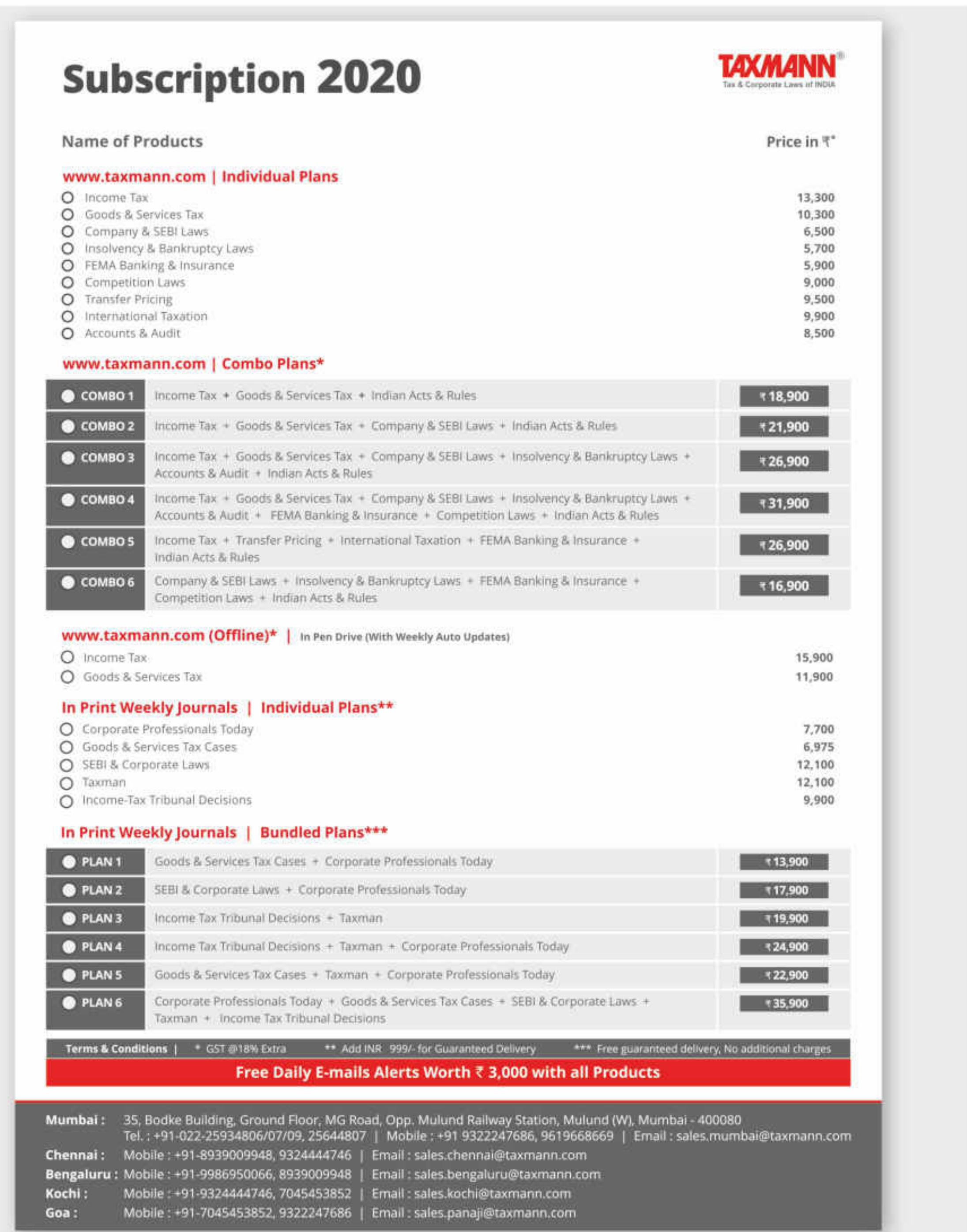
THE CHAMBER'S JOURNAL
Posted at the Mumbai Patrika Channel
Sorting Office, Mumbai 400 001.
Date of Posting: 15th-16th of Every Month

No. MCS/149/2019-21
R.N.I. No. MAHENG/2012/47041
Date of Publishing 12th of Every Month



Printed and Published by Shri Kishor D. Vanjara on behalf of The Chamber of Tax Consultants, 3 Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020 and Printed at Finesse Graphics & Prints Pvt. Ltd., 309 Parvati Industrial Premises, Sun Mill Compound, Lower Parel (W), Mumbai - 400 013. Tel.: 4036 4600 and published at The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020. Editor : Vipul B. Joshi