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# Taxation of Charitable Trusts - Live Issues

## Half Day Seminar on Charitable Trusts

## Chamber of Tax Consultants

## 23rd March 2018

# Depreciation on Assets

- Section 11(6) introduced wef AY 2015-16
- *Where any income is required to be applied or accumulated or set apart for application, then, for such purposes, the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year*
- Applicable if cost of acquisition claimed as an application of income u/s 11 – similar explanation added to section 10(23C) – only clauses where income required to be applied/accumulated – not applicable to s.10(23C)(iiiab), (iiiac),(iiiad),(iiiae)
- Cases where earlier exempt u/c (iiiab)/(iiiac)/(iiiad)/(iiiae) – now claiming u/c (vi)/(via)?

# Depreciation on Assets

- Refers to deduction under the same section – exemption earlier claimed u/s 10(23C), now under section 11 or vice versa?
- Claiming of cost of acquisition as application of income –
  - Cost may have been claimed in AY 2015-16 onwards or before
  - Allowance of depreciation in earlier years is not claim as application of income
  - Applicable if claimed u/s 11(1)(a)
  - What if claimed as application of s.11(2) accumulation?
  - What if acquired as a corpus donation, or out of corpus donation?
  - What if acquired out of funds accumulated u/s 11(1)(a) – 15%?

# Depreciation on Assets

- Whether applicable retrospectively for earlier years
- Recent SC decision in case of Rajasthan & Gujarati Charitable Foundation Poona TS-596-SC-2017-SC dated 13.12.2017
- Whether amounts to double deduction?
- Whether amendment applicable to Assessment Years prior to AY 2015-16?
- Reference to Bombay HC decision in CIT v Institute of Banking Personnel Selection 264 ITR 110:
- *The Tribunal, however, took the view that when the ITO stated that full expenditure had been allowed in the year of acquisition of the assets, what he really meant was that the amount spent on acquiring those assets had been treated as 'application of income' of the Trust in the year in which the income was spent in acquiring those assets. This did not mean that in computing income from those assets in subsequent years, depreciation in respect of*

# Depreciation on Assets

- *those assets cannot be taken into account. This view of the Tribunal has been confirmed by the Bombay High Court in the above judgment [DIT(E) v. Framjee Cawasjee Institute [1993] 109 CTR 463].*
- View taken by the Bombay HC correctly states the principles of law
- The legislature, realising that there was no specific provision in this behalf in the Income Tax Act, has made amendment in S. 11(6) of the Act vide Finance Act No. 2/2014 which became effective from the AY 2015-2016
- The Delhi HC has taken the view and rightly so, that the said amendment is prospective in nature
- It also follows that once the assessee is allowed depreciation, he shall be entitled to carry forward the depreciation as well

# Insertion of Explanation 2 to s.11(1)

- Any amount, credited or paid, out of income from property held under trust to corpus of another trust registered u/s 12AA – not to be treated as application of income
- Similar provision added as twelfth proviso to s.10(23C) – voluntary contribution to corpus of trust registered u/s 12AA
- Explanatory Memorandum to Finance Bill 2017 – Anti Abuse Measures
  - *However, donation given by these exempt entities to another exempt entity, with specific direction that it shall form part of corpus, is though considered application of income in the hands of donor trust but is not considered as income of the recipient trust. Trusts, thus, engage in giving corpus donations without actual applications.*

# Insertion of Explanation 2 to s.11(1)

- Income from property held under trust includes voluntary contributions – s.12(1)
- Both provisions not applicable to contributions made to corpus of s. 10(23C) institutions
  - ACIT vs Shiksha Samiti [2015] 60 taxmann.com 428 (Delhi - Trib.)
- Not treated as application – applicable both to application of income in current year as well as in subsequent year under explanation to s.11(1), besides accumulation u/s 11(2)
  - donations to other trusts do not qualify for utilisation of accumulation
- Effectively, corpus donations to be made would now need to be funded either out of corpus donations received or out of 15% accumulation

# Application for Reregistration u/s 12AA

- Insertion of clause (ab) in s.12A(1) – wef 1.4.2018
- If adopted or undertaken modification of objects which do not conform to conditions of registration – if application not made in prescribed form and manner within 30 days from date of adoption/modification – loss of exemption
  - From which year – whether procedural or substantive?
  - Whether applicable to past cases of modification of objects prior to April 2017? Position of such cases
  - Meaning of date of adoption/modification – vis-à-vis
    - Trust – date of trustee resolution, date of court order?
    - Society – date of managing committee resolution, date of AGM resolution, date of AGM confirmation resolution?
    - Company – date of BoD resolution, date of AGM resolution, date of filing resolution with RoC?

# Application for Reregistration u/s 12AA

- Draft of Modified Form No 10A & Rule 17A published for public comment on 17.10.2017 – final rule and form notified on 19th February 2018
- Form 10A to be furnished electronically
  - Under digital signature, if return furnished under digital signature
  - Through EVC in other cases
- Type of trust – whether charitable, religious or religious-cum-charitable
- If charitable, category of charitable purpose – education, relief of the poor, medical relief, yoga, preservation of monuments or places or objects of artistic or historic interest, preservation of environment or advancement of any other object of general public utility

# Application for Reregistration u/s 12AA

- Act under which registered
- If falling u/s 12A(1)(ab)
  - Details of existing registration
  - Date of modification of objects
- Whether trust deed contains clause that trust is irrevocable?
- Whether any registration application has been rejected in the past? Details
- Whether registered under FCRA 2010? Details

# Loss of Exemption for late filing of return

- Insertion of clause (ba) in s.12A(1)
- Return to be filed within time specified in s.139(4A)
- Applicable for each year – late filing in one year will not impact subsequent year's exemption
- Before due date u/s 139(1)
  - Loss of accumulation u/s 11(2) if Form No 10 not filed
  - Loss of option to spend in subsequent year if Form No 9A not filed
  - Loss of exemption u/s 11 if income tax return not filed
- What if delay on account of reasonable cause?

# Accumulation u/s 11(2)

- Accumulation in case of unspent income – for a period of 5 years
- Furnishing of Form No 10
- CIT v Nagpur Hotel Owners Association 247 ITR 201 (SC) – form can be furnished anytime till the completion of assessment
- CIT v Sakal Relief Fund (2017) 295 CTR 561 (Bom) - even if Form 10 was filed during reassessment by assessee-trust, benefit of accumulation under section 11(2) was available because such filing would be considered within time allowed for furnishing return of income under section 139(4) – followed Association of Corporation & Apex Societies of Handlooms v. Asst. DIT [2013] 351 ITR 287 (Del)
- Decision may no longer apply after amendment wef AY 2016-17
- Online form – requires specification of amount accumulated for each purpose separately – earlier combined accumulation for multiple purposes was permissible – can form override law?
- Modification of amount within purposes specified – whether requires approval of AO u/s 11(3A)

# Corpus Donations

- Corpus donations exempt u/s 11(1)(d)
- If exemption u/s 11 not available – whether taxable?
- S.2(24)(iia) – voluntary contributions received by a trust created wholly or partly for charitable or religious purposes
- Is corpus donation a capital receipt, and therefore not taxable at all?
- Would section 56(2)(x) read with section 2(24)(xviia) apply?
- DIT v Basanti Devi & Shri Chakhan Lal Garg Education Trust ITA 927/2009 dated 23.9.2009 (Del HC) - donations received towards corpus of the trust would be capital receipt and not revenue receipt chargeable to tax.
- Followed in ITO v Smt Basanti Devi and Shri Chakhan Lal Garg Education Trust ITA No 5082/Del/2010 dated 19.1.2011

# Corpus Donations

- Shri Shankar Bhagwan Estate v ITO [1997] 61 ITD 196 (Cal)
  - *So far as s.2(24)(iia) is concerned, this section has to be read in the context of the introduction of the present s.12. It is significant that s.2(24)(iia) was inserted with effect from 1-4-1973 simultaneously with the present s.12, both of which were introduced from the said date by the Finance Act, 1972. S.12 makes it clear by the words appearing in parenthesis that contributions made with a specific direction that they shall form part of the corpus of the trust or institution shall not be considered as income of the trust. The Board's Circular No. 108 dated 20-3-1973 is extracted at page 1277 of Vol. I of Sampat Iyengar's Law of Income-tax, 9th Edn. in which the inter-relation between s.12 and s.2(24)(iia) has been brought out. Gifts made with clear directions that they shall form part of the corpus of the religious endowment can never be considered as income.*
- ITO v Gaudiya Granth Anuved Trust (2013) 28 ITR (Trib) 161 (Agra)
  - Corpus donation is in the nature of a capital receipt and is not taxable, irrespective of whether the trust is registered u/s 12AA or not

# Corpus Donations

- Chandraprabhu Jain Swetamber Mandir v ACIT [2017] 82 taxmann.com 245 (Mum)
  - Corpus donations received by the assessee-trust with specific directions by the donors to be applied towards the specific purpose for which the respective funds were created, would be treated as capital receipts being capital in nature and were not taxable despite fact that the trust was not registered under section 12A/12AA
- ITO v Serum Institute of India Research Foundation [2018] 90 taxmann.com 229 (Pune)
  - Held in various cases decided earlier that the corpus donation received by the trust, which is not registered under section 12A/12AA, is not taxable as it assumes the nature of 'capital receipt' the moment the donation is given to the "Corpus of the Trust".

# Interest on Corpus

- Only corpus donations exempt u/s 11(1)(d)
- Interest on corpus would normally be regarded as income – 85% required to be applied
- CIT v Mata Amrithanandamayi Trust (2017) 85 taxmann.com 261 (Ker)
- Donors had instructed that the interest earned shall be added to the corpus of the trust
- Interest earned on the contributions already made by the donors would also partake the character of income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust
- Interest earned would qualify for exemption under Section 11(1)(d)

# Educational Institution - Surplus

- Where educational institution earns surplus, whether it can be said to be not charitable?
- **Queens Educational Society v CIT 372 ITR 699 (SC)**
- Surplus during relevant years
- Surplus had enabled the assessee to acquire its own property, computers, library books, sports equipments etc. for the benefit of the students
- Members of the assessee society had not utilized any part of the surplus for their own benefit
- Whether eligible for exemption u/s 10(23C)(iiiad)

# Educational Institution - Surplus

- For s.10(23C)(iiiad) and (vi), law is as under

(1) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes incidental surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit.

(2) The predominant object test must be applied - the purpose of education should not be submerged by a profit making motive.

(3) A distinction must be drawn between the making of a surplus and an institution being carried on 'for profit'. No inference arises that merely because imparting education results in making a profit, it becomes an activity for profit.

(4) If after meeting expenditure, a surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes.

(5) The ultimate test is whether on an overall view of the matter in the concerned assessment year the object is to make profit as opposed to educating persons

# Educational Institution - Surplus

- It is clear that when a surplus is made by an educational society and same is ploughed back for educational purposes, the educational institution is to be held to be existed solely for educational purposes and not for purposes of profit
- The 13th proviso to section 10(23C) is of great importance as in terms of it, assessing authorities must continuously monitor from assessment year to assessment year whether such institutions continue to apply their income and invest or deposit their funds in accordance with the law laid down. Further, it is of great importance that the activities of such institutions be looked at carefully. If they are not genuine, or are not being carried out in accordance with all or any of the conditions subject to which approval has been given, such approval and exemption must forthwith be withdrawn
- Followed & reiterated in CCIT v St Peter's Educational Society 385 ITR 66 (SC)

# Educational Institution - Surplus

- **Visvesvaraya Technological University v ACIT 362 ITR 279 (Kar)**
- Where predominant object of activity is educational purposes and not to earn profit, whether it would lose its character because it makes profit from the activity
- As long as 'surplus' is 'reasonable surplus', there should not be any difficulty
- Clear as crystal that University gets huge income every year by way of convocation fee & examination fee from Examination Authority and that percentage of grants extended by State Govt to university were hardly 1 per cent of total receipts
- Surplus more than double the expenditure for 10 years - more than Rs.500 crore
- University collects huge sums, 3-4 time more than the requirement. Such 'surplus', cannot be stated to be incidental
- University systematically making profit – not reasonable surplus
- Though the University was set up for educational purpose, it is now a profiteering institution

# Educational Institution - Surplus

- **Visvesvaraya Technological University v ACIT 384 ITR 37 (SC)**
- The entitlement for exemption under section 10(23C)(iiiab) is subject to two conditions. Firstly the educational institution or the university must be solely for the purpose of education and without any profit motive. Secondly, it must be wholly or substantially financed by the government. Both conditions will have to be satisfied before exemption can be granted under the aforesaid provision of the Act
- The relevant principles of law which will govern the first issue, i.e., whether an educational institution or a university, as may be, exists only for educational purpose and not for profit are no longer res integra, having been dealt with by a long line of decisions of this Court which have been elaborately noticed and extracted in a recent pronouncement i.e. Queen's Educational Society v. CIT [2015] 372 ITR 699 (SC) in which it was held that when a surplus is ploughed back for educational purposes, the educational institution exists solely for educational purposes and not for purposes of profit
- There can be no doubt that the surplus accumulated over the years has been ploughed back for educational purposes. In such a situation, following the

# Educational Institution - Surplus

- **Visvesvaraya Technological University v ACIT 384 ITR 37 (SC)….**
- consistent principles laid down by this Court referred to earlier and specifically what has been said Queen's Educational Society (supra), it must be held that the first requirement of section 10(23C)(iiiab), namely, that the appellant University exists solely for educational purposes and not for purposes of profit is satisfied
- Collection of fees does not amount to funding by the Government, merely because collection of such fees is empowered by the statute
- Funds received from the Government contemplated under section 10(23C)(iiiab) must be direct grants/contributions from governmental sources and not fees collected under the statute
- As not substantially financed by the Government, not eligible for exemption u/s 10(23C)(iiiab)

# First Proviso to s.2(15)

**DIT(E) v Shree Nashik Panchvati Panjrapole (2017) 81 taxmann.com 375 (Bom)**

- Trust established 130 years before for protecting cows and oxen
- Selling milk and earning interest and dividend
- Dominant function of the Trust is to provide an asylum to old, maimed, sick and stray cows
- Only 25% of the cows being looked after yielded milk and if the milk was not procured, it would be detrimental to the health of the cows
- Milk which is obtained and sold by the trust is an activity incidental to its primary/principal activity of providing asylum to old, maimed, sick and disabled cows
- Activity of milking the cows and selling the milk is almost compelled upon the trust, in the process of giving asylum to the cows
- Activity to be considered in the nature of trade, commerce or business would in most cases have to be carried out on a regular basis with a view to earn the profit
- Presence of the profit intent (even if it does not fructify) would normally be a sine qua non for the activity to be considered as trade, commerce or business

# First Proviso to s.2(15)

- It is not as though the keeping of the cows and milking them was with a view to carry out activity in the nature of trade, commerce or business to earn profits
- Dominant activity carried out by the respondent assessee's trust for over 130 years is to take care of old, sick and disabled cows
- Incidental activity of selling milk which may result in receipt of money, by itself would not make it trade, commerce or business nor an activity in the nature of trade, commerce or business to be hit by the proviso to section 2(15)
- There is no bar in law to a trust selling its produce at market price – this factor alone will not make it an activity of trade, commerce or business or even in its nature

# First Proviso to s.2(15)

**Ahmedabad Urban Development Authority v ACIT(E) 396 ITR 323 (Guj)**

- Constituted as Urban Development Authority by the State Govt in exercise of powers u/s 22 of Gujarat Town Planning & Urban Development Act, 1976
- Functions - to undertake the preparation of development plans under the provisions of the Act for the urban development area; to undertake the preparation and execution of town planning schemes under the provisions of the Act, if so directed by the State Govt; to execute works in connection with supply of water, disposal of sewerage and provision of other services and amenities; to acquire, hold, manage and dispose of property, movable or immovable, as it may deem necessary; and to carry any development works in the urban development area as may be assigned to it by the State Govt
- Purpose and object of constitution of the Urban Development Authority is proper development or re-development of urban area
- Constitution of the UDA is subject to the control of the State Govt
- Town Planning Scheme prepared by the UDA which has been prepared subject to sanction by the State Govt for development of the Urban Development Area, also provide for roads, open spaces, gardens, recreation grounds,

# First Proviso to s.2(15)

- schools, markets, green-belts, dairies, transport facilities, public purposes of all kinds; drainage, inclusive of sewerage, surface or sub-soil drainage and sewage disposal; Lighting; Water supply, etc
- UDA is permitted to sell the plots/lands to the extent of 15% of the total area to meet with the expenditure towards drainage, roads, gardens, schools, markets, water supply etc
- Entire amount realized by the UDA is either by selling plots or by recovery of some fees/charges, which it is required to use only for the purpose of development in the Urban Development Area and not for any other purpose
- By no stretch of imagination, it can be said that the activities of AUDA can be said to be in the nature of trade, commerce or business and/or its object and purpose is profiteering
- No services are rendered to any particular trade, commerce or business
- Activities of the assessee cannot be said to be in the nature of trade, commerce and business
- Merely because the assessee is collecting cess or fees which is regulatory in nature, proviso to s. 2(15) of the Act shall not be applicable

# First Proviso to s.2(15)

- Having regard to the purpose for which the assessee is established/constituted under the provisions of the Gujarat Town Planning Act, collection of fees and cess is incidental to the object and purpose of the Act
- The case would not fall under second part of proviso to s. 2(15)
- Similar view taken in CIT v Gujarat Industrial Development Corporation (2017) 83 taxmann.com 366 (Guj)

# First Proviso to s.2(15)

**CIT(E) v Water & Land Management Training & Research Institute [2017] 83 taxmann.com 234 (Hyderabad HC)**

- Institution established under the control of the Irrigation Dept of the State Government of Andhra Pradesh
- Filed application for registration u/s 12AA
- Functioning mainly as a training institute for the purpose of training various Government officials in the field of water and land management
- Also providing guidance to farmers and rendering consultancy services to various organizations by charging certain fee
- Director as well as the Tribunal took view that the activities of the assessee would fall within the ambit of the words 'advancement of any other object of general public utility‘
- Omitted to take note of the activity, namely, 'preservation of environment including water-sheds, forests and wildlife
- The activity carried out by the assessee had a direct casual connection to the activity of preservation of environment
- First proviso to s.2(15) not applicable

# First Proviso to s.2(15)

**Delhi Bureau of Text Books v DIT(E) [2017] 81 taxmann.com 412 (Del)**

- Engaged in printing and publication of text books for students of Government Schools, 'NDMC' Schools and Delhi Cantonment Schools
- Books were provided at subsidized rates by the assessee
- Also distributing free books, reading material and school bags to needy students
- Claimed exemption under sections 11 and 12
- According to AO, since the assessee was earning huge profit margins of about 35.15%, the activity of publication and sale of books could not be said to be a 'charitable activity‘
- Interpretation of the word “education”
- The essential activity of the assessee is connected with 'education' and nothing else
- Preparation & distribution of text books certainly contributes to the process of training & development of the mind and the character of students. There does not have to be a physical school/institution to be eligible for exemption. What is important is the activity. It has to be intrinsically connected to 'education'

# First Proviso to s.2(15)

- Merely because the assessee had generated profits out of the activity of publishing and selling of school text books it did not cease to carry on the activity of 'education'.
- The question to be asked was whether the activity of the Assessee contributed to the training and development of the knowledge, skill, mind and character of students?
- Engaged in activity of education

# First Proviso to s.2(15)

**CIT(E) v Pushpawati Singhania Research Institute for Liver, Renal & Digestive Diseases [2017] 386 ITR 43 (Delhi)**

- Running a hospital which was approved as a charitable institution u/s 12A
- Maintained separate books of accounts for the research activity and for the activity of running the hospital
- Received monies from other hospitals, outside laboratories and from drug store run on licence basis within hospital premises
- Accepted that such receipts incidental to attainment of the objects
- Exemption denied on ground that separate books of account not maintained for such income
- Tribunal rightly held that activities were incidental to the main activity of the hospital itself and were not undertaken with a profit earning motive
- Tribunal also found that it maintained separate ledgers for each of the sources of income and thereby fulfilled the requirement of Section 11(4A)
- Tribunal decision upheld

# First Proviso to s.2(15)

**CIT(E) v Patanjali Yogapeeth (NYAS) [2017] 87 taxmann.com 54 (Delhi)**

- Engaged in propagation of yoga by conducting classes at regular intervals
- AY 2009-10 – claim that activity amounted to 'imparting of education'
- Several pathies & methods by which the medical relief is achieved. These pathies are allopathy, homeopathy, naturopathy, Ayurvedic, Unani, Yoga etc. and a person suffering from any disease, including chronic diseases, approaches these pathologies and method for the relief
- For such person the pathy or method from which he gets relief is the medical relief from the method or pathy followed by him
- Ultimate goal of all these pathies and methods is to achieve relief and certainly Yoga is one such method or pathy
- Practice of yoga gives positive reliefs in the cases of asthma, migraine, hypertension, stress etc
- The mere inclusion of yoga specifically w.e.f. 01.04.2016 did not per se imply that it came to be included as a specific charitable category on the same lines as education, medical relief, relief to the poor, etc but that dissemination of yoga or vedic philosophy or the practice of yoga or education with respect to yoga was well within the larger term "medical relief"

# THANK YOU