

Taxation of Charitable Institutions

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Meaning of Charitable Institutions?

- The words “Trust” which have been used in the income Tax Act at the most of the places.
- Further a clarification has been made stating the meaning of the trust by CBDT.
- The word Trust has an inclusive definition for the purpose of Act, which includes
 - Trusts,
 - Societies and
 - Companies under section 8 /25



Meaning of Charitable Institutions.....?

- There are 2 guidelines notes till yet by ICAI
 - Guidelines Note on Audit of Public Charitable **Institutions** under the Income Tax Act 1961.
 - Taxation of Education and Charitable **Institutions** under Income Tax Act 1961.
- Following the guidelines notes of the ICAI, the **word institution** has been used here in the discussion, even though the act uses the word Trust.



Topics ?

- Broad map of Taxation of Charitable Institutions?
- Charitable Purpose?
- Registration & Cancellation of Registration?
- Income?
- Application of Income?
- General Deductions and Exemptions ?



Section 139(4A)

- Return is required to be filed by every person
 - In receipt of **income derived from property held under trust or other legal obligation** wholly for charitable or religious purposes or in part only for such purposes, or
 - Income being voluntary contributions referred to in section 2(24)(iia),
 - shall, if the total income in respect of which he is assessable as a representative assessee (the total income for this purpose being computed under this Act **without giving effect to the provisions of sections 11 and 12)** **exceeds the maximum amount which is not chargeable to income-tax.**



Section 2(24)(iia)

- Voluntary contributions received by a trust are included in the definition of income as such **“Contributions”** received by a trust created wholly or partly for charitable or religious purposes.

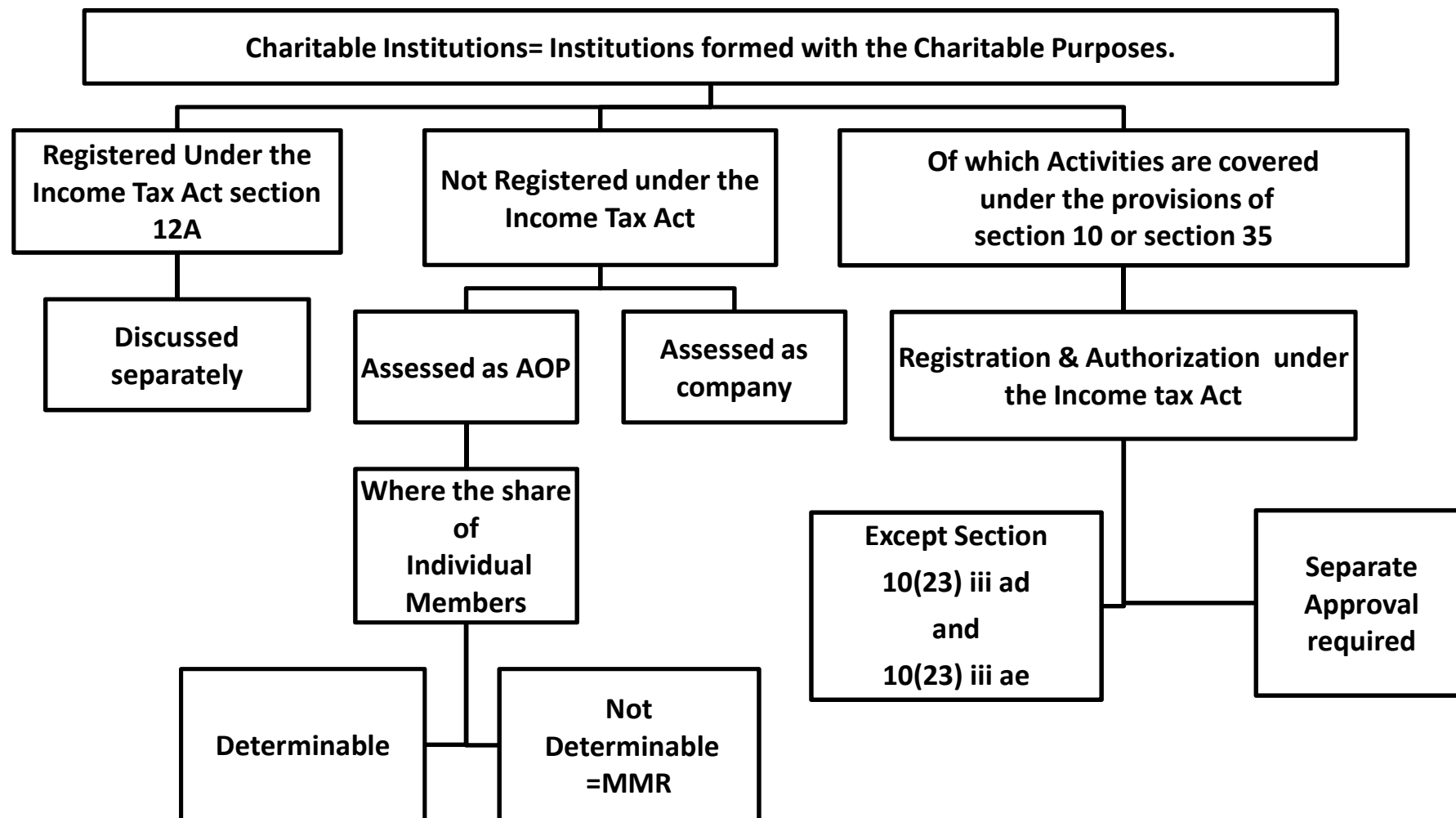


Broad map of Taxation of Charitable Institutions?

	Form Number ITR-7 Other Details (Page Number-2)
A	Whether activities of the trust under the residuary clause 2(15)?
B	Whether trust is claiming exemption under section 10(23C) iiiad/10(23C0 iiiad?
C	Whether the activities of the trust : Charitable or Religious?
D	Whether approval under section 35?
E	Whether approval under section 80-G?
F	Whether there is a change in the objects?
G	Whether it's a return of income of the Political Parties?
H	Whether it's a return of income of the Electrol Trust ?
I	Whether FCRA approval is required?
J	Whether trust is liable to be taxed at the MMR under section 164?
K	Whether it's the first return of income of the trust?

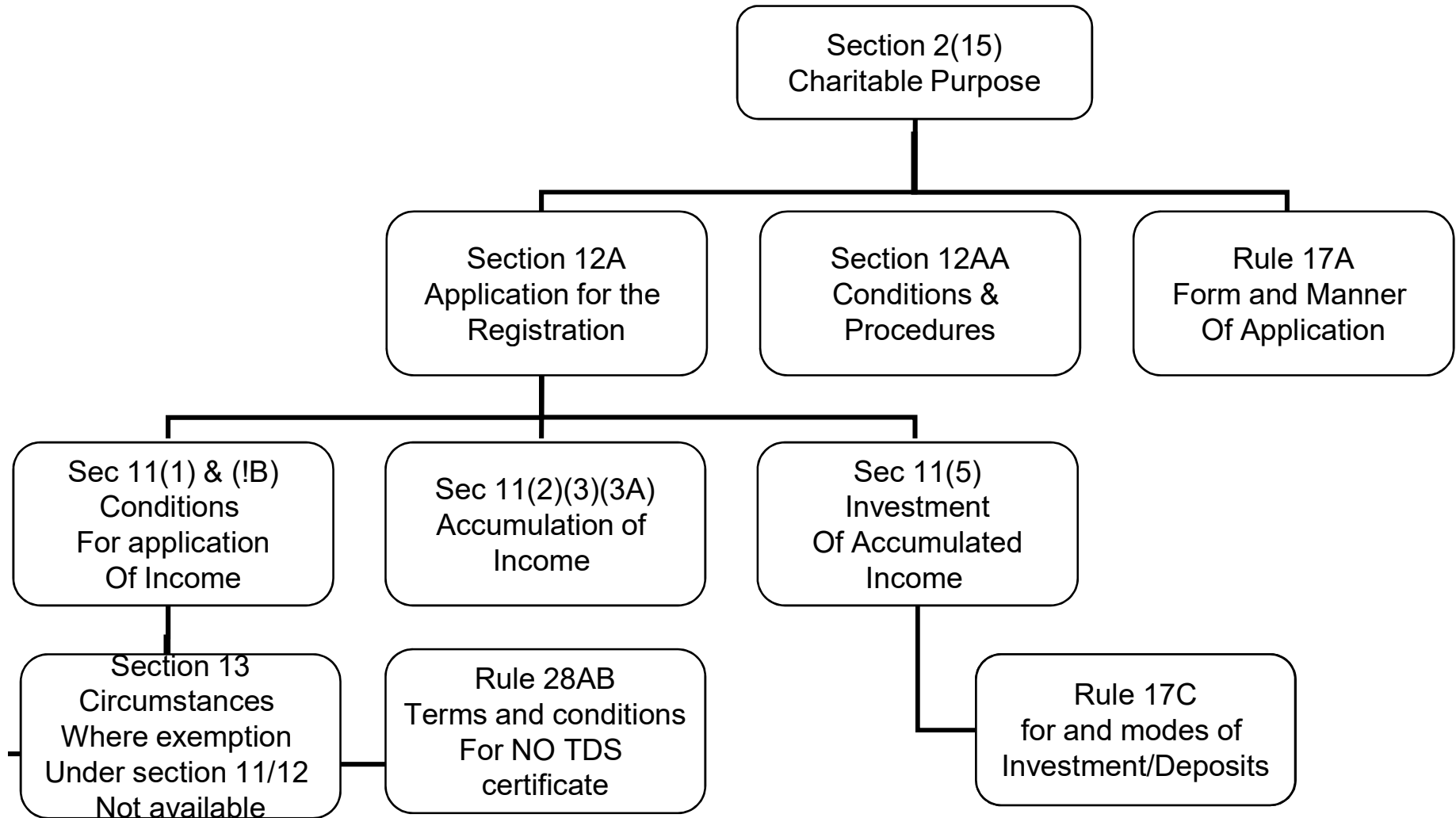


Broad map of Taxation of Charitable Institutions....?





Broad map of Taxation of Charitable Institutions....?





Charitable Purpose?

- Defined in section 2(15) of the act and includes **(6) main objects** as under:
 - Relief of the Poor
 - Education
 - **Yoga (w.e.f. Assessment year 2016-17)**
 - Medical relief
 - Preservation of
 - Environment or wild life,
 - Historical Monuments or Places
 - Objects of artistic or Historical interest
 - Advancement of any other object of general public utility.



Charitable Purpose.....?

- Advancement of any other object of general public utility is a **Residuary clause**.
- Concept is based of **Question of Facts**
- Includes
 - **Religious Purposes.**
 - **Trade, commerce, business or services** in relation to the respective activities **following the principles of “Mutuality”**
 - **In absentia of the “Mutuality” general public utility word will be only mask/device to hide the true purpose of trade, commerce and business.**



Charitable Purpose.....?

– Chambers of Commerce.

- CIT v. Federation of Indian Chambers of Commerce & Industry [1981] 130 ITR 186 (SC)

– Promotion of Trade & Commerce during the course of diamond export.

- Director of Income-tax (Exemptions) v. Bharat Diamond Bourse [2003] 126 Taxman 365 (SC)

– Stock Exchanges

- Hyderabad Stock Exchange Ltd. v. CIT [1967] 66 ITR 195 (AP)

– Bar Councils

- CIT v. Bar Council of Maharashtra [1981] 130 ITR 28 (SC)



Charitable Purpose.....?

- Establishing the schools for only Muslims to teach Urdu, Arabic etc are charitable.
 - (138 ITD 519 Lucknow)
- Scholarship granted to poor students of a particular community are charitable.
 - (23 Taxmann.com 311)
- Charging huge fees in addition to the fees as prescribed by the government is found non charitable.
 - (139 ITD 307 Amritsar)



Charitable Purpose.....?

- Collection of the capitation fees from students for giving admission would **not entitled to deduction under section 11**
 - **(30 ITR 120 Hyderabad Tribunal)**
- Non affiliated institution providing coaching are **not the charitable activities**
 - **(51 SOT 175 Cochin)**
- Coaching are charitable activities **if have some affiliation with some Board, university or some Recognised Institution are charitable activities.**
 - **(225 Taxmann 223 Gujarat)**



Charitable Purpose.....?

- Taking care of sick animals are the charitable activities
 - (53 SOT 495 Mumbai)
- Maintenance and development of Park is charitable activities
 - (53 SOT 495 Mumbai)
- Organizing Marathon in commercial manner is **not a charitable activities**
 - (139 ITD 464 Hyderabad)
- Yoga training is a charitable activities and **Not hit by the ceiling of CBDT Circular.**



Charitable Purpose.....?

- Production and broadcasting the TV and Radio Programme is **not a charitable activities.**
 - **(21 Taxmann.com 533 Karnataka)**
- Preference to relatives is not relevant for the determination of charitable purposes.
 - **36 ITR 513 (SC)**
- Entire mankind need not be benefited under the charitable purposes.
 - **82 ITR 704 (SC)**
- Finally the onus is on the assessee to prove that **objects are of a charitable nature.**



Business Activities and Charitable Purpose?

- Twin Test theory.

No Gap

– Income from the property held in the name of trust should not be less than the Income determined by the assessing officer in accordance with the provisions of the Act.

Section
11(4A)

– Conditions as laid down in section 11(4A) must be satisfied i.e.

- The business so carried on by the institution **must be incidental to attainment of the objects .**
- **Separate Books of accounts** are maintained by the institution in respect of such business.

– **In absentia subject to tax as per AOD/ROI**



Business Activities and Charitable Purpose.....?

- Advancement of any other objects of general public utility & Business Activities.
 - A lot of amendments has been made in the Act in this regard by the **Finance Act 2008, 2010, 2011 and 2015.**
 - Advancement of any other objects of general public utility **shall not be a charitable purpose if it involves any activity of the nature of Trade, Commerce, Business or Services for a Fees, Cess or other consideration.**



Business Activities and Charitable Purpose....?

- This restriction shall not be application if total receipts from any such business activities does not exceed the limit as mentioned below:

	Assessment year	Receipts from the Business activities
1.	2009-10 to 2011-12	Rs. 10 lakh during the previous year
2.	2012-13 to 2015-16	Rs. 25 lakh during the previous year
3.	2015-16 onwards	20% of <u>Total Receipts</u> during the relevant previous year

- **CBDT Circular NO. 11/2008 dated 19-12-2008**

- The monetary limits shall not be applied in respect of the first 5 limbs of section 2 (15) of act



Business Activities and Charitable Purpose.....?

- CBDT circular and Business activities
 - The business activities may be carried on if the objects covers the other charitable purposes. e.g.
 - Relief to destitute,
 - Orphans or handicapped or disadvantaged people including women and children
 - Small and marginal farmers,
 - Senior citizens
 - Other conditions as mentioned in section 11(4A) must be satisfied.
 - Other activities as specified under section 2(15) may



Registration of the Trust under the Income Tax Act ?

- Application with the CIT (Exemption) in form Number 10A
- **Registration under section 12A of the act is precondition , For the purpose of availing the exemption under section 11 & 12.**
- **Only objects may be examined for the purpose of the granting the registration not the activities.**
 - **213 Taxmann 1 (Punjab & Haryana),**
 - **219 Taxmann 136 (Karnataka),**



Registration of the Trust under the Income Tax Act.....?

- At the stage of registration, Initial contribution made by founder of trust and dedication thereof towards the object may not be examined.
 - 13 SOT 54 (Delhi)
- Registration may not be refused on the ground of some permissions are pending to be obtained to run the school etc.
 - 5 ITR 127 (Chennai)



Registration of the Trust under the Income Tax Act.....?

- Registration may not be denied, Just on the ground that the applicant **failed to apply for registration since last several years** and also failed to file the return of income.
 - **211 Taxman 311 (Allahabad)**
- **No condition may be imposed** while granting the exemption by the CIT
 - **203 Taxmann 171 (Delhi)**
 - **143 ITD 297 (Delhi)**



Registration of the Trust under the Income Tax Act....?

- The registration may not be recommended to be withdrawn by the AO just on the ground that
 - No charitable activities is carried on during the relevant previous year,
 - Major activities were in general in nature,
 - 687-688 ITA 2015 Chandigarh



When to apply for Registration?

- Provisions from **01-04-2007** onwards
 - **No time limit** for moving an application for the registration.
 - Previous year (Financial year) in which the application is moved, the **registration is granted from the first date of that previous year.**
 - **No power to Condon the delay** in this regard.
 - This **results into the hardship** and additional tax liability if institution fails to apply in due course **due to some genuine reason.**



When to apply for Registration.....?

- **Amendments from Assessment year 2014-15**
 - Benefit of section 11 and 12 shall be available **if any proceeding for an earlier assessment year is pending before the assessing officer as on the date of such registration** and
 - Objects of such activities in relation to the pending assessment are the same as those on the basis of which such registration has been granted.
 - **This relaxation is not available in case, any pending proceedings under section 147 .**



ne frame/passing the order granting the Registration?

- Within 6 months from the end of month in which the application for the registration is received by the CIT (Exemption),
- An order must be passed for either
 - Granting the Registration or
 - Refusal of the Registration
- In case of the refusal for granting the registration,
 - The reasons must be stated in such order.



ne frame/passing the order granting the Registration.....?

- In case of invalid application,
 - This limit will be application equally.
 - 23 SOT 49 (Jaipur)
 - 31 SOT 1 (Mumbai)
- Failure to pass the order may
 - lead into a presumption that registration has been granted.
 - 58 SOT 185 (Jodhpur)
 - 91 ITD 1 (Bangalore)
 - 3 SOT 229 (Delhi)



Registration & other aspects?

- Registration is not an
 - *ipso facto* entitlement of the assessee to claim exemption under section 11.
 - 75 ITD 362 (Ahmadabad)
 - 77 ITD 50/118 Taxmann 143 (Delhi)
- The validity is further subject to
 - the examination during the course of the assessment
 - in relation to the activities carried on and condition as mentioned in section 13 of the Act by the AO.



Registration & other aspects.....?

- Amendment in finance Act 2017
 - Previously charitable trust did not require for the fresh registration upon any changes or modification in its object clause,
 - However with this new amendment it is proposed that trust registered under section 12AA will require a fresh registration certificate by making an application to the Assessing Officer within 30 days from the date of such changes or modifications of the objects.



Cancellation of Registration?

- Power for cancellation lies only in hands of the CIT (Exemption) if he is satisfied that
 - The activities of the trust are not genuine.
 - The activities are not carried out in accordance with the object of the institution.
- There cannot be any other reasons for withdrawal of exemption except above mentioned (2) reasons.
 - 42 SOT 343 (Chandigarh)
 - 219 Taxmann 115 (Punjab)



Cancellation of Registration.....?

- **Amendments from Assessment year 2014-15**
 - Same as earlier except the following changes vide Finance Act 2014
 - **If the activities of the institution exclude either whole or any part of the income due to operation of section 13 (1).**



Operation of
section 13

Cancellation of Registration.....?

- Income is used directly or indirectly for the benefit of interested persons,
 - If trust is created on or after 01-04-1962
 - No benefit to the persons, as specified in section 13(13) of the Act.
 - The word person includes the following:
 - The Author/Founder/Creator of the trust
 - Substantial contributor (contribution exceeding Rs. 50000/-) of the trust during the relevant previous year. Such contributor may be another trust also.



Cancellation of Registration.....?

- Any member of HUF or relative of such member of HUF who has created the trust/Founder/Author of the trust.
- **Trustee or Manager or any other controller** of the trust
- Any **Relative** of all above said person.
- Any other concern in which any of such person referred above has a **Substantial interest**.
- The **word Founder** must be constructed objectively
 - This just means the **originator of the Institution**.
- Thus clause **will apply in all subsequent years equally.**



Cancellation of Registration.....?

- Contribution in monetary terms is not a only test.
 - 126 Taxman 365 (SC).
- The word Trust again must be understood in wider sense including the various entities.
 - 118 Taxman 556 (Calcutta)
- The words Relative is the same as in case of section 56(2) of the Act.
- The word Substantial Interest mean if such a person or persons
 - Hold at least 20% of or more the equity share capital or
 - Have the 20% or more the profit sharing ratio.



Cancellation of Registration.....?

- Satisfaction is generally **recorded and recommended by the AO**
 - During the course of assessment in the assessment order.
- CIT then may pass an **order in writing**
 - After affording an **opportunity to be heard** to the assessee.
- Registration shall not be cancelled if
 - The assessee proves that **there was a reasonable cause** for the activities to be carried out in the said manner as mentioned in section 12(1) of the Act



Cancellation of Registration.....?

- Merely because all trustees are family members,
 - It does not mean that trust is not a public trust.
 - Further no activities may never be said that stopping the activities for ever.
 - 128 TTJ 118 (Ahmadabad)
- In case of search operation with Trust,
 - The CIT cannot utilize his power before the completion of the assessment of search .
 - 23 SOT 74 (Cuttack)



Cancellation of Registration.....?

- In case some amount is not found to be spent towards the objects of the trust,
 - No cancellation of the registration of the trust
 - Only benefit of exemption under section 11 may be kept limited.
 - 53 SOT 167 (Ranchi)
- Denial of exemption under section 10 (23C)
 - This cannot be a sole reason for the cancellation of the registration of the trust
 - 40 Taxmann.com 32 (Allahabad)
 - 38 Taxmann.com.173 (Allahabad)



Cancellation of Registration.....?

- Amendment in section 2(15) by fixing monetary cap in relation to the commercial activities.
 - **This cannot be a sole reason** for the cancellation of the registration.
 - **142 ITD 565 (Cochin)**
 - **141 ITD 1 (Chennai)**
 - **147 ITD 112 (Mumbai)**
- If trust **does not start charitable activities** after the registration, no cancellation
 - **222 Taxmann 11 (Allahabad)**



Cancellation of Registration.....?

- Income from Private Religious Purposes
 - Which does not ensure benefit of the public
 - This may result into the forfeiture of exemption.
- Income for the benefit of particular Religious Community, caste or breed.
 - If trust is formed on or after 01-04-1962
 - Exception of this rule: if trust is meant for the benefit of SC, ST, Women and Children
 - If trust is formed to benefit only Muslims, then also exemption may be withdrawn.



Cancellation of Registration.....?

- Non maintenance of Proper books of Accounts?
 - There is a difference between the word **books of accounts** & **Accounts** maintained by the assessee.
 - The **word proper** has not been defined in the Act.
 - This only mean enabling the Assessing officer to compute the income in the lawful manner.
 - **Quoting the Accounting Standards has no meaning to prove the word proper** as it has been violated at many places in the act and even by the circular of CBDT which says law will prevail then the AS.



Cancellation of Registration.....?

- Funds not invested as specified in section 11(5)
 - Exemption is available only if at least 85% of income is applied for charitable purposes.
 - Remaining 15% must be invested in the forms or modes as specified in section 11(5).
 - Both the requirements will have to be fulfilled before the trust can claim and avail of the exemption under section 11(1)(a).
 - It is only then that the entire income of the trust will get the exemption.
 - Circular Number 335, Dated 13-04-1982.



Cancellation of Registration.....?

- There is difference in between the
 - Investment of the 15% of the accumulated income and
 - Additional accumulation of income beyond 15%.
- If assessee wants the exemption of its additional accumulated income,
 - The assessee is required to invest the additional accumulated income in the manner as laid down in section 11(5) and not the entire accumulation.
 - 216 ITR 697 (SC)
 - 230 ITR 636 (SC)



Cancellation of Registration.....?

- Specified modes of Investment (Section 11(5)). This list has been made easy and not an exhaustive list.
 - Government securities (Central or State)
 - Post office Savings Bank Account
 - **Any account (current or other) with scheduled or cooperative bank**
 - UTI, debentures of Central or State Government undertakings
 - **Public deposits** of the Central or State Government undertakings (w.e.f. Assessment year 2001-02)
 - **Immovable properties.**
 - **Remember there is no cash in hand in this list.**



Cancellation of Registration.....?

- Consequences of violation of section 11(5)
 - **Only violated amount is liable to be taxed and not the denial of exemption** under section 11 on total income of the assessee.
 - **44 Taxmann.com 275 (Karnataka)**
 - **SLP against the judgment is dismissed by Supreme Court on 19-09-2014. 227 Taxman 369 (SC).**
- Educational and Medical Facilities to specified persons (Section 12(2) & 13(6))
 - Such an income **shall be deemed to be the income of such trust** and shall be chargeable to income tax .



Main conditions for exemption under section 11?

- The Property from which income is derived should be held
 - Under the name of the trust
 - For charitable purposes.
- The word “Property” must be understood objectively and not at all subjectively.
 - Includes and income derived from ASSETS in the name of the trust such as
 - Immovable /Movable properties/liquid assets.
 - Investments,
 - Business carried on by the charitable institutions



Main conditions for exemption under section 11?

- In case the Trust is formed after 01-04-1962 then further conditions
 - It should not be created for particular religion or community or caste.
 - No party of the income should be encouraged directly or indirectly for the benefit of the settler or other specified person.
 - Property must be held wholly for charitable purposes.
- Except first, all other conditions shall equally be applied in case of Religious Trust created on or before 01-04-1962.



Main conditions for exemption under section 11?

- The exemption is confined to only such portion of the trust's income which is
 - Applied for the charitable purposes or
 - Accumulated for applying to such purposes within the permitted limits.
- The exemption is further restricted to only such portion of income as is
 - Applied in India.
- The trust must apply for the Registration
 - In the year its get the registration.

Section 11(1) & (2)

Section 11(1) (c)



Main conditions for exemption under section 11.?

Section 11 & 12

- The Accounts of the trust must be **Audited**
 - For such accounting year in which the **Total Income** exceeds the minimum exemption limit of **Rs. 50000/-**
 - The **word total income means**
 - Income as defined in section 11 **plus**
 - Contributions with specific direction received .
 - Income which are **exempt under section 10 like dividend etc. shall not be included.**
- The funds of the trust must be **deposited in the prescribed manner.**

Section 11(5)
49



Main conditions for exemption under section 11.?

- **Amendments from the Assessment year 2015-16**
 - When the trust is granted the Registration, under section 12AA of the Act
 - Such a trust **cannot claim any other exemption under any provision of section 10**
 - Except **The exemptions under section 10 (23C).**



How to make the Computation of Income ?

	Particulars	Amt
1.	Amount of <u>Income</u> of the Trust/Institution (Before giving the exemption under section 11 of the Act)	-
2.	<u>General Deduction/Exemption</u> under section 11 of the Act (15%) of the Income of the Trust/Institution	-
3.	Income of the Trust/Institution <u>available for application</u> (1-2)	-
4.	Details of the <u>Income Applied</u> including the <u>Capital and Revenue expenditure</u> for the charitable purposes	-
5.	Balance If (3-4) is positive	-
6.	Check whether any income has been <u>Set apart for future?</u> If yes then show it	-
7.	If still there is balance (5-6) = Taxable Income of the trust	-



Main ingredients of Computation of Income?

- Income
- General Deduction/Exemption
- Income applied or application of income
- Income set apart for the future



How to compute the Income?

- **CBDT Circular dated 19-05-1968**
 - This clearly state that income in this context must be understood in **“COMMERCIAL SENSE”**.
- Commercial Sense?
 - **Section 11 Does not provide mode of computation** of income of the trust, **BUT** Provides the **quantum of application of income**
 - Thus this is based on **application of income.**
 - Hence only **Real Income which is based on actual realization and not at all the NOTIONAL.**



How to compute the Income.....?

- Thus income for the purpose of section 11
 - Means the Real Income Which has been Received by the trust.
 - Income will not be computed in accordance with the Provisions of Income Tax Act.
 - This will be calculated as per the Normal Rule of Accounting but based on accounting conventions
 - Accumulation and application in section 11(1) (a) must be of the Real income.



How to compute the Income, Some Issues?

- Income Tax Deducted at source
 - This may not be considered as income.
 - Income to be applied under section 11(1) has to be ascertained after considering the TDS.
 - 24 Taxman 36 (Gujrat).
- Income tax refund are also not the Income.
 - 120 Taxman 186 (Delhi)
- Tax-free income/Agriculture income
 - Not form part of Income for the purpose of accumulation of income in excess of 15%.



How to compute the Income, Some Issues.....?

- Voluntary Contribution with a direction
 - Not the part of Income.
 - Onus is entirely on the assessee to show that donations are given with a direction to form the part of corpus of the trust.
 - Merely showing such some under the corpus of the trust does not mean the compliance of the law till the evidences to prove that is not furnished.

Section
2(24)(ia)

any other contribution/donation

- Deemed to be the part of income derived from the property held in the name of the trust.



How to compute the Income, Some Issues.....?

- Donation through the BOX.
 - With some messages must be treated as forming part of the corpus of the trust/society
 - If objects are not under the Residuary clauses.
 - 133 TTJ 57 (Chandigarh).
- Only donor may decide the direction and not at all the trust.
 - The trust has no discretion to decide the matter.
 - 12 Taxmann.com 375 (Vishakhapatnam)



How to compute the Income, Some Issues.....?

- One time Admission fees
 - In accordance with the Bye Laws for acquiring capital assets or one time subscription fees received from the members shall be treated as the corpus of the trust.
 - 130 TTJ 377 (Delhi)
- Grant Received
 - Whether of capital nature or revenue in nature, cannot be regarded as voluntary contribution.
 - One has to apply the purpose test.
 - The source of grant is immaterial
 - 306 ITR 392/174 Taxman 87 (SC)



How to compute the Income, Some Issues.....?

– The grant is always given with some direction and not at the absolute disposal of the trust to utilize the same by the trust.

- 18 Taxmann.com364 (Delhi)
- 90 ITD 493 (Hyderabad),
- 71 ITD 152 (Hyderabad)
- 149 ITR 470 (Rajasthan),
- 145 ITR 29 (Madras),



How to compute the Income, Some Issues.....?

- Income from the House Property
 - Receipts on account of rent must treated as income
 - **No statutory deduction of 30%.**
 - The
 - Municipal taxes,
 - Repairs and maintenance
 - Other expenses to maintain and preserve the property.
 - shall be the **application of income on actual payment basis.**
 - **No notional income** if more then one house property lying vacant.



How to compute the Application of Income?

- Application of income
 - Disposal of Income for the charitable or religious purpose.
 - There is a difference in all 4 words
 - Expenditure = In Mercantile system of accounts
 - Payment = In Cash system of accounts
 - Applied/application = In commercial sense.
 - Sanctioned = Only approved subject to further conditions.
 - 131 ITR 497 (Andhra Pradesh)
 - 179 Taxman 144 (Karnataka)

Only Real
Income
may be
applied



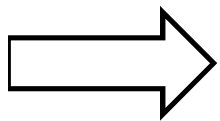
How to compute the Application of Income.....?

- Depreciation till assessment year 2014-15
 - Allowed as application even if cost of assets has been fully allowed as application under section 11 in the earlier years at the time of acquisition.
 - 105 CTR 303 (Gujrat)
 - 91 Taxman 40 (Delhi)
 - 131 Taxman 386 (Mumbai)
- Depreciation from assessment year 2015-16
 - In case of application of income or income set apart for future,
 - such an application of income will not consist any allowance by way of depreciation or otherwise,
 - on the assets which already been claimed to be applied in the earlier previous year



How to compute the Application of Income.....?

- Educational purpose loans by Educational Trust to students.
 - Application in the year of advance
 - At the time of return of loan, income of the trust.
 - In case such an advance bears Interest, the activity shall be the Money Lending Business
 - CBDT Circular No, 100, Dated 24-01-1073.
- Capital vs. Revenue Expenditure
 - Both are application of income if incurred for the attainment of the object.
 - 133 ITR 779 (Madras)
 - 50 SOT 48 (Delhi)





How to compute the Application of Income.....?

- Payment of Taxes

- If out of current years income, its an application.

- The reason may be the several one e.g.

- To preserve the corpus and or the assets

- Necessity to attain the objects.



- Even the entire income may be applied for the payment of taxes etc.

- This may relates to the year beyond the question.

- 23 Taxman 416 (Madras)

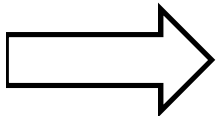
- 127 ITR 378 (Andhra Pradesh)

- 83 Taxman 422 (Bombay)



How to compute the Application of Income.....?

- Donation to other Trust/Institutions
 - Only point which is to be examined is, **such donation must be out of current years income only.**
 - Examination of **utilisation of such donation by the donee trust/ institution is not at all a matter.**

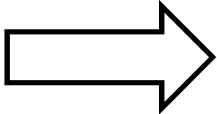


- **172 ITR 698 (Gujrat)**
- **239 ITR 502 (SC)**
- **226 ITR 394 (Gujrat)**
- **211 Taxman 32 (SC)**



How to compute the Application of Income.....?

– Donation at the time of dissolution of the trust.

- 
- In case such donation is made **NOT** out of **income but out of the accumulated income, during the course of dissolution of the trust,**

- 
- then such donation **shall not be treated as application** of income.

- 
- The donation shall be
 - Taxed in the year in which such payment/credit on account of donation is made.

– This provision is not applicable in case if,

- **Donation is made out of accumulation up to 15% of income as per section 11(1)(a) of the Act.**



How to compute the Application of Income.....?

- Recent amendment in Finance Act 2017
 - A new explanation to section 11 of the Income Tax Act has been inserted to provide that **any amount paid or credited, out of income referred in section 11(1) (a)/11(1) (b) of the Income Tax Act, being specific contributions** that they should form part of the corpus donation of the charitable/religious trust or charitable institution, shall not be regarded as an application of income of the trust.
 - As a result, from Financial Year 2017-18 and onwards any charitable/religious/private trust making any contribution to another trust along with the specific direction then such donation/contribution will not be regarded as the application of income and that it shall form part of corpus donation in the hands of donor trust



How to compute the Application of Income.....?

- Contravention of trust objects of the trust **but for charitable purposes.**
 - **Its an application** as what relevant under section 11 is for the Charitable purposes.
 - **65 CTR 290 (Andhra Pradesh)**
- Prior Period Expenditures
 - **No as such distinction in section 11(1)(d)** therefore an application of income.
 - **119 CTR 144 (Gujrat)**
 - **105 Taxman 719 (Madras)**



How to compute the Application of Income.....?

- Expenses for defending the Criminal Cases
 - If in relation **to protect the trust or trust property**
 - **76 Taxman 88 (Calcutta)**
- Repayment of loan
 - If amount of loan is not taken as income then the repayment thereof will not be application.
 - Only the **interest component shall be the application of income and vice versa.**
 - **242 ITR 703 (Karnataka)**



How to compute the Application of Income.....?

- Business Income
 - **Property** includes **Business undertaking so held.**
 - In case AO find that **income from such undertaking is not included in the income of the trust,**
 - Then he may compute the Business Income in accordance with the provisions of the Act.
 - Such an excess income shall be **deemed to be applied for the purposes other than the charitable purposes** as per the provisions of section 11(4).
- ➡ – This applies only in case when **assessed income is more than returned income.**



How to compute the Application of Income.....?

- Excess application of Income of previous year
(Forget Accounting in this case)
 - May be setoff against the current year of income.
 - Provided in the earlier year such an **amount must be shown in assets as an excess application and not at all set off against balance of General Reserve. (only real loss may be set off)**
 - **242 ITR 20 (Madras)**
 - Amount of excess income applied of earlier year
should be after the General Deduction.
 - **22 SOT 359 (Mumbai)**



How to compute the Application of Income.....?

— Examples :

	Assessment Yea 2014-15	Example-1	Example-2
1.	Income for the year	100000/-	100000/-
2.	Income applied during the year	86000/-	101000/-
3.	General deduction (15% of Income stated in col. 1)	15000/-	15000/-
4.	Deficit (1-2+3)	1000/-	16000/-

— Example -1, no set off available in the subsequent years for Rs. 1000/- as the balance of general deduction was available to cover the same.

— Example -2, set off is available in the subsequent years but for Rs. 1000/- and not of Rs. 16000/-



How to compute the Application of Income.....?

- Additions of unexplained investments
 - Any additions made under section 69 of the Act, during the assessment, **may be treated as application of income.**
 - **121 TTJ 829 (Lucknow)**
- Capital gain on transfer of capital assets
 - Full value of consideration reduced by incidental expenditure shall be the income of the trust.
 - **Acquisition of new assets shall be the application of income.**
 - In case part consideration is applied then remaining may be applied for other activities also.



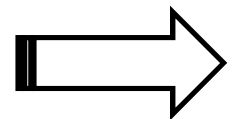
How to compute the Application of Income.....?

- Capital gain and contrary views?
 - Excess of sale consideration over the indexed cost of acquisition must be treated as income.
 - 68 ITJ 244 (Amritsar)
- Investment in FD with PSU's /Bank?
 - This may be treated as acquisition of new assets.
 - Such investment must be Long Term one.
 - 206 ITR 152/73 Taxman 380(Calcutta)
 - 115 Taxman 520 (Delhi)



General Deduction or Exemption?

- This is 15% of the income which may be accumulated by the trust for the future purposes.
 - This means 85% of the income must be applied mandatorily
 - By the trust to claim the income exempt.
- When application of income falls short of 85% of the Income?
 - There are 2 options to handle this situation.
 - The details may be seen in next slide





General Deduction or

	<ul style="list-style-type: none">•Application of income falls short of 85% of Income•Due to the following reasons	Options –1 & 2 When such short fall of application of income may be spent
1	Income <u>has not been received</u> during the relevant previous year	<ul style="list-style-type: none">•During the <u>previous year in which income is so received</u> OR <ul style="list-style-type: none">•During the <u>previous year immediately following such previous year</u>
2	Any other reason	During the <u>previous year immediately following such previous year in which the income was derived.</u>



General Deduction or Exemption...?

- How to avail the benefit of Extended time?
 - As per Explanation 2 of the section 11(2) of the Act, **Exercise the option in writing.**
 - This must be done **within the time allowed under section 139(1)** for the filing the return of income.
 - Then short fall of application of income shall be **deemed to be applied during the previous year in which such income was derived.**



General Deduction or Exemption?

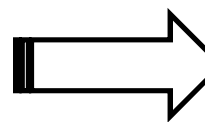
- In case of belated return filed under section 139(4),

The option is exercised in writing in a statement along with such return, the requirements of the explanation to section 11(1) will stand satisfied.

- 73 Taxman 612/207 ITR 368 (Bombay)
- 144 Taxmann 300 (Madras)

- When income is not fully applied during the extended time for the said purpose.

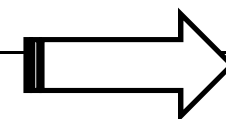
➡ – Such income shall be taxed as per next slide :





General Deduction or

	Situation	Taxability
a	If income is not <u>received</u> in the previous year & the option is exercised <u>to apply the income in the year of receipt,</u>	Receipt which is not spent <u>during the year of receipt & the immediately following year</u> -Such a receipt shall be taxable as the <u>income of immediately following year</u>
b	If the income is not spent in the year in which it is <u>derived</u> & the option is exercised <u>to apply the income in the next year</u>	The amount <u>not spent in the next year shall be taxable as income of the next year.</u>





General Deduction or Exemption.....?

Received

Derived

	<u>Examples</u>	Option -1	Option -2
1	Income for the Previous Year 2012-13 actually received during the previous year 2015-16	26000/-	26000/-
2	Amount spent during the previous year 2015-16	15000/-	NIL
3	Amount spent during the previous year 2016-17	3000/-	18000/-
4	Unutilized amount (1-2+3)	8000/-	8000/-
5	Income for the previous year 2016-17	Yes	Yes
6	Amount of income	8000/-	26000/-



General Deduction or Exemption?

- Further compliances in relation to income Set Apart
 - A notice must be given to the Assessing officer in **Form 10** for the purpose and period for which the income is accumulated or set apart.
 - Form 10 must be **uploaded electronically**
 - **Due date shall be or on before the due date of filing the return of income under section 139(1)**
 - **Failure to upload the form 10, will loose the entitlement of accumulation**
 - **Income set apart of income and such income will be taxed as per rate.**



General Deduction or Exemption?

- Income may be accumulated for the period not exceeding the 5 years immediately succeeding the year in which such income has been received.
- Money set apart must be invested or kept in the specified form as mentioned in section 11 (5).
- Failure to do so by the trust will result into the imposition tax on such income in the year default is made.
- The trust may give a notice in writing in Form 10 for more than one year in order to claim accumulation of income under section 11(2).



General Deduction or

Exemption?

- Such claim may not be denied mere on the ground that in subsequent year or years no further notice is given by the assessee.
 - 20 SOT 187 (Mumbai)
- Failure to apply the income due to unavoidable circumstances, the AO may allow such income for other charitable purposes on the application moved by the trust.
- In case accumulation or set apart of income is not particularized as much as they cover entire range of the objects of the trust, the application may not be denied of such income.
 - 166 Taxman 147 (Delhi).



General Deduction or

Exemption?

- Amendment w.e.f. Assessment year 2017-18,
 - benefit of accumulation is not available to the trust
if return of income is not furnished within the time as prescribed in section 139(1) of the Act.



Anonymous Donations

section 13(7) ?

- Amendment in section 13 was made w.e.f. assessment year 2007-08.
- Now such donation are taxed at the MMR
 - Anonymous Donations (Section 115 BBC(3))
 - Its must be a voluntary contribution as referred to in section 2 (24)(iia).
 - Not applicable in case when the donations are made with the specific direction (Corpus)
 - The person receiving the contribution does not maintain record in relation to the Identity indicating
 - The names of donors and
 - Address of donors.



Anonymous Donations

- **Provisions applicable on the following:**
 - Trusts referred to in section 11 of the act.
 - Universities and institutions referred to in section 10 (23C)(iiiad)
 - Hospitals and institutions referred to in section 10 (23C)(iii ae)
 - Fund an institutions referred in section 10(23C) (iv) (v) and (via)
- **Provisions are not applicable when**
 - **Donations received by a trust established wholly for religious purposes**



Anonymous Donations

section 13(7)....?

- This section is applicable only when

	Monitory ceilings	Application
1	Aggregate amount of donation is less then Rs. 100000/-	Not applicable
2	Aggregate amount of donation is more then Rs. 100000/- but not more than 5% of total donation received by the trust	Not applicable
3	Aggregate amount of donation <u>is more then Rs. 100000/- and also more than 5% of total donation received</u> by the trust	The <u>excess</u> amount will be taxed at the MMR.



Concept of mutuality?

- **No man can make a profit out of himself.**
- Mutuality postulates Complete Identity between the contributors and participants i.e. **(Concept of BY, OF and FOR)**
 - All the contributors to the common fund must be entitled to **participate** in the surplus and
 - All the participators in the surplus must be contributors to the **common fund**.
 - All the Contributors' right of **disposal** over surplus is a **must**.



Concept of mutuality.....?

- For the concept of mutuality, it is not necessary that
 - Members contributing to the fund and members enjoying the benefits should be identical individuals.
 - But it is sufficient if members are identical as a class
 - **The fact that temporary or honorary members may go out of the scheme and other new members may come in will not make any difference to the principle.**
 - Darjeeling Club Ltd (1985) 153 ITR 676 (Calcutta)



Mutuality under Income Tax Act?

- Income Tax Act recognizes the principle of mutuality in section 2(24) & sec 28(iii)
 - **Section 2(24)(vii)** Profits and gains of any business of insurance carried on by a mutual insurance company or by a cooperative society (Section 44 r.w First Schedule)
 - **Section 2(24)(viii)** the profits and gains of any business of banking (including providing credit facilities) carried on by cooperative society with its members.
 - **Section 28(iii)** income derived by a trade, professional or similar association from specific services performed for its members (Section 44A)



Concept of mutuality and Transactions with Members?

- Income derived by the club for supply of drinks, refreshment or other goods as also letting out of building for rent or the amounts received by way of admission fees, periodical subscription etc from the members of the club, not tainted with commerciality - exempt under Mutuality.
 - **Bankipur Club Ltd (1997) 226 ITR 97 (SC)**
- It is not only the surplus from the activities of the business of the club but even the annual value of the club house , as contemplated in Section 22, to which the principle of mutuality applies.
 - **Chelmsford Club (2000) 243 ITR 89 (SC)**



Concept of mutuality and Transactions with Non-Members?

- Principle of mutuality can be claimed in respect of receipts from members but not in respect of receipts from non-members
 - **(1992) 196 ITR 137 (Patna)(FB)**
- Rental income from letting marriage hall to nonmembers who were made temporary members only for the purpose of such letting- not covered under principles of mutuality. –
 - **Trivendrum Club (2006) 282 ITR 505 (Kerla).**



Concept of mutuality and Interest & Dividend etc. earned

- Interest on fixed deposit and investments by a club does not form part of the principle of mutuality –
 - Amar Singh Club Vs UOI (2009) 184 Taxman 481,
 - Coimbatore Cosmopolitan Club (2010) 34 DTR 62,
 - ITI Employees Death & Superannuation Relief Fund (1998) 234 ITR 308 (Kerla)
- Interest on Deposit with member bank Principle of mutuality not applicable
 - Bangalore Club (2006) 287 ITR 263 (Karnataka)



Concept of mutuality

Interest & Dividend etc. earned....?

- Income earned by Assessee Society by way of interest and dividend by making investment of surplus fund which is wholly contributed by members is governed by the principles of mutuality.
 - **Canara Bank Golden Jubilee Staff Welfare Fund (2009) 308 ITR 202 (Kernataka)**
 - **All India Oriental Bank of Commerce Welfare Society (2003) 130 Taxman 575 (Delhi)]**



Concept of Mutuality and Charity or Both?

- Main question under this concept are
 - Whether Mutuality and Charity exclusive?
 - Whether exemption can be claimed both under Mutuality as well as under Section 11?
- Charitable entities under greater scrutiny by the Department.
- Refrain from using charitable entities for collateral purposes



Concept of Mutuality and Charity or Both.....?

- Under DTC, application of income on regular basis imperative, failure to do so results in chargeability to tax.
- Clubs should reconcile themselves to claiming exemption qua mutuality.
- Charitable status may not continue for long.
- Mutuality will be given restrictive meaning.
- Revenue generation from sources unrelated to members would be chargeable.

Acknowledgement

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Thanks a lot

**For further clarification Please contact on
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