

Taxability of Charitable & Religious Trusts

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What are trusts?

Trusts have not been defined under the Income-tax Act, 1961. The dictionary meaning of "trust" in so far as it relates to the realm of law is "an arrangement" by which property is handed over to or vested in a person, to use and dispose it off for the benefit of another person."

Trusts can be broadly classified into two categories, *viz.*,

- (i) Public,
- (ii) Private.

However, there may be trusts which are a blend of both and are known as Public-*cum*-Private Trusts.

Public trust: A public trust is one which benefits the public at large or some considerable portion of it. A public trust can be of two types, *viz.*, (a) Public charitable trust, (b) public religious trust.

Private trust: In case of private trust, the beneficiaries are individuals or families. Private trusts are further broadly classified into:

- (i) Private specific trust, also referred to as Private Discretionary Trust with beneficiaries and shares determinate in respect of both.
- (ii) Private Discretionary Trust where the beneficiaries or their share or either is indeterminate.

Private Trusts are created and governed by Indian Trusts Act, 1882 whereas charitable trusts are beyond this Act and have not been defined by law. According to section 3 of this Act, a trust is an obligation annexed to the ownership of the 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. 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*, the person for whom the benefit is created is called the *beneficiary*.

The subject-matter of the trust is called *trust property* or *trust money*, the *beneficial interest* or *interest* of the beneficiary is his right against the trustee as owner of the trust-property; and the instrument, if any, by which the trust is declared is called the *instruments of trust*.

From the analysis of the above definitions, it may be observed that three types of persons are involved in the creation of a trust

- (i) Author of the trust *i.e.* the person who reposes or declares the confidence;
- (ii) Trustees *i.e.*, the persons who accept the confidence;
- (iii) Beneficiary *i.e.*, the person(s) for whose benefit the confidence is accepted.

In case of private trusts, the beneficiary may be another person or the author.

Public-cum-Private Trusts: There may be certain trusts whose part of the income may be applied for public purposes and a part may go to a private person or persons. Such trusts are known as Public cum Private Trusts. Such trusts, in respect of the portion of the income going to private person or persons are assessable as private trusts and in respect of that portion of the income which is applied for public purposes, they shall be eligible for exemption under section 11 provided these trust are created before the commencement of Income-tax Act, 1961 *i.e.* before 1-4-1962.

A public-cum-private trust may become a fully public trust on the private beneficiary or beneficiaries renouncing his or their rights, which one is entitled to do under the provisions of section 58 of the Indian Trusts Act, 1882 [*CIT v Kasturbai Walchand Trust* (1967) 63 ITR 656 (SC); *CIT v Trustees of Sir Kikabhai Premchand Trust* (1967) 65 ITR 213 (Bom)].

Is a trust deed necessary to create a trust?: For creation of a valid trust, it is not necessary to execute a "trust deed". The trust may be testamentary (deed in writing) or non-testamentary (without a written deed). The latter are referred to as oral trusts.

Creation of a Trust

A Private Trust may be created *inter vivos* or by will.

The following are the requisites for creation of a Trust:

- (i) The existence of the *author/settlor* of the Trust or someone at whose instance the Trust comes into existence and the settlor to make an unequivocal declaration which is binding on him.
- (ii) There must be a *divesting of the ownership* by the author of the trust in favour of the trustee for the beneficial enjoyment by the beneficiary.
- (iii) *A Trust property.*
- (iv) The *objects* of the trust must be precise and clearly specified.
- (v) The *beneficiary* who may be particular person or persons.

Unless all the above requisites are fulfilled, a trust cannot be said to have come into existence.

Creation of a Public Trust: Like the private trusts, public trusts may be created *inter vivos* or by will. In the case of *Hanmantram Ramnath v CIT* (1946) 14 ITR 716 (Bom) it was held that "Although the Indian Trusts Act does not specifically apply to charitable trusts, there are three certainties required to create a charitable trust. They are:

- (i) a declaration of trust which is binding on settlor,
- (ii) setting apart definite property and the settlor depriving himself of the ownership thereof, and
- (iii) a statement of the objects for which the property is thereafter to be held, *i.e.* the beneficiaries."

A formal deed is not necessary to constitute a public trust, still less to constitute a legal obligation binding the trustees. In the case of a dedication to a public trust, what is essential is that there should be an unambiguous expression of intention to divest and an actual divestment of the interest of the donor for the benefit of the charity. Such divestiture can be proved by a written document or by other evidence as it is not necessary that there should be a writing to constitute a valid dedication. [*Jai Narayan Jai Govind v Controller of E.D.* (1963) 49 ITR (ED) 105, 117 (Mad)].

It is essential that the transferor of the property *viz* the settlor or the author of the trust must be competent to contract. Similarly, the trustees should also be persons who are competent to contract. It is also very essential that the trustees should signify their assent for

acting as trustees to make the trust a valid one.

When once a valid trust is created and the property is transferred to the trust, it cannot be revoked, If the trust deed contains any provision for revocation of the trust, provisions of sections 60 to 63 of the Income-tax Act will come into play and the income of the trust will be taxed in the hands of the settlor as his personal income.

Public Trusts for Charitable or Religious Purposes

The income of charitable or religious trusts is exempt from tax u/s 11 subject to the fulfilment of certain conditions. However, any profit or gain of a business carried on by such trust shall not be exempt unless the business is incidental to the attainment of the objectives of the trust/institution and separate books of accounts are maintained by such trust/institutions in respect of such business.

Exemption under sections 11 to 13

Subject to the provisions of sections 60 to 63, certain incomes of a charitable/ religious trust or institution are not included in its total income *to the extent and subject to the conditions* specified in the Act. The word *Trust* as used in the context of sections 11 to 13 of the Income-tax Act, includes in addition to the trust "*any other legal obligation*".

What is a "legal obligation"?: Trust itself is a legal obligation, as the trustees are legally bound to apply the income of the trust in the manner and for the purposes specified by the author of the trust and it includes the following:

- (i) Property of the estate of deceased held by executor(s) under a legal obligation.
- (ii) Section 25 "companies" or "Guarantee Companies". Such companies are also holding the properties under legal obligation.
- (iii) Muslim Wakfs.
- (iv) Religious Endowments under the Hindu Law.
- (v) Institutions registered under the Societies Registration Act, 1860 as the properties of the society are held under a legal obligation.
- (vi) Bar Councils, Chamber of Commerce, endowments, monasteries, maths, etc. are all instances where the "property is held under legal obligation".

Subject to the provisions of sections 60 to 63: Section 11 starts with the opening phrase "subject to the provisions of sections 60 to 63. It means that if there is:

- (a) a transfer of income without transfer of an asset; or
- (b) revocable transfer of assets,

the income from that asset, in that case, shall be taxable in the hands of transferor and not the transferee.

Sections applicable for charitable or religious trust

The following sections of the Income-tax Act deal with the subject of exemption of income from property held for charitable or religious purposes:

- Section 11 Exemption of Income from property held in trust or other legal obligation, for religious or charitable purposes.
- Section 12 Exemption of Income derived by such a trust from voluntary contributions not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution.
- Section 12A Prescribes the conditions for registration of a trust etc.
- Section 12AA Prescribes the procedure for registration.
- Section 13 Enumerates the circumstances under which exemption available under

sections 11 and 12 will be denied.

Exemption under section 11: For claiming exemption under section 11, the following conditions must be satisfied:

- (a) Trust must have been created for any lawful purpose;
- (b) Such trust/institution must be for charitable or religious purposes. According to section 2(15), *charitable purpose* includes relief of the poor, education, medical relief and the advancement of any other object of general public utility;
- (c) The property from which income is derived should be held under trust by such charitable or religious trust/institution.
- (d) The accounts of the trust/institution should be audited for such accounting year in which the total income, before giving effect to provisions of section 11 or 12, exceeds Rs. 50,000 and the person in receipt of the income should obtain an audit report in Form No. 10B (Rule 17B) and furnish the same alongwith the return of income.

However, in the case of *CIT v Hardeodas Agarwalla Trust* [(1992) 198 ITR 511 (Cal)] it has been held that an omission to file audit report alongwith the return of income may be rectified by filing the report at a later stage before assessment is completed.

- (e) The trust must get itself registered with the Commissioner of Income-tax within the prescribed time.
- (f) The charitable trust created *on or after 1-4-1962* should satisfy the following further conditions:
 - (i) it should not be created for the benefit of any particular community or caste;
 - (ii) no part of the income of such charitable trust or institutions should enure directly or indirectly for the benefit of the settlor or other specified persons; and
 - (iii) the property should be held wholly for charitable purposes.

However, the *religious trust* created *before or after 1.4.1962* may not satisfy the condition (i) mentioned above, but if it is created after 1-4-1962, it should satisfy the conditions (ii) and (iii) mentioned above.

Thus, the charitable trust or religious trust created before 1-4-1962 can be partly public charitable or religious trust and partly private charitable/religious trust but charitable or religious trust created after 31-3-1962 should be wholly for charitable or religious purposes.

Judicial decisions on charitable purpose

Promotion of sports — whether a charitable purpose — clarification regarding: The board has clarified that promotion of sports and games can be considered to be a charitable purpose within the meaning of section 2(15) of the Income tax Act, 1961. Therefore, an association or institution engaged in promotion of sports and games can claim exemption under section 11 of the Income tax Act, 1961, even if it is not approved under section 10(23) of the Act relating to exemption from tax of sports associations and institutions having their objects as the promotion, control, regulation and encouragement of specified sports and games. [*Circular No. 395, dated 24th September, 1984*].

Relief of poor: The relief of the poor must not be relief to a body of private individuals but must have a public character [*Mercantile Bank of India (Agency) Ltd.* (1942) 10 ITR 512 (Cal)]. Therefore trusts for the relief of poverty of poor relatives of the settlor were not for a charitable purpose since no element of public benefit was involved. [*CIT v Jamal Mohd. Sahib*

(1941) 9 ITR 375 (Mad)].

Education: What education connotes in section 2(15) is the process of training and developing the knowledge, skill, mind and character of students by normal schooling [*Sole Trustee, Loka Shikshana Trust v CIT* (1975) 101 ITR 234, 241 (SC); *Addl. CIT v Victoria Technical Institute* (1979) 120 ITR 358, 370-1 (Mad)]. Education, in order to be charitable, must relate to the public and a trust created for the education of the members of a family or the descendants of a certain named individual are not for charitable purposes [*D.V. Arur v CIT* (1945) 13 ITR 465 (Bom)]. Though newspapers have an educative value, advancement of education results only indirectly. Advancement of education resulting indirectly does not come under the head of education. [*CIT v Sole Trustee, Loka Shikshana Trust* (1970) 77 ITR 61, 75 (Mys)].

Any other object of general public utility: General means pertaining to a whole class; public means the body of people at large including any class of the public; and utility means usefulness. Therefore, the advancement of any object of benefit to the public or a section of the public as distinguished from an individual or a group of individuals, would be of charitable purpose. [*CIT v Ahmedabad Rana Caste Association* (1973) 88 ITR 354 (Guj)].

The expression object of general public utility, however, is not restricted to objects beneficial to the whole mankind. An object beneficial to a section of the public is an object of general public utility. To serve a charitable purpose, it is not necessary that the object should be to benefit the whole of mankind or even all person living in a particular country or province. It is sufficient if the intention is to benefit a section of the public as distinguished from specified individuals. The section of community sought to be benefited must undoubtedly be sufficiently defined and identifiable by some common quality of a public or impersonal nature: where there is no common quality uniting the potential beneficiaries into a class, it might not be regarded as valid charitable trust. [*CIT v Andhra Chamber of Commerce* (1965) 55 ITR 722 (SC)].

State Bar Council has been held to be a body constituted for general public utility although its objects are beneficial to section of a public. [*CIT v Bar Council of Maharashtra* (1981) 130 ITR 28 (SC)].

The Satsangis of Radhaswami Satsang Sabha being followers of one religion, are cross-section of the public, and a charitable trust for the benefit of Satsangis as such must be deemed to be a trust for an object of a general public utility. [*CIT v Radhaswami Satsang Sabha* (1954) 25 ITR 472 (All)].

A trust created for charitable or religious purposes will enjoy the exemption although it is named after a private person. [*CWT v HEH The Nizam Supplemental & Religious Endowment Trust* (1973) 89 ITR 80 (AP)].

Where the primary objects are, charitable, exemption cannot be denied if a subsidiary object is found to be non-charitable but which is intended to subserve the religious and charitable objects. [*Yograj Charity Trust v CIT* (1976) 103 ITR 777 (SC)].

If the predominant object of the activity of a trust is of general public utility, it will not lose its character of a charitable purpose merely because some profit arises from its activities. [*CIT v Ganesh Tam Laxinarain Goel* (1984) 147 ITR 468 (MP)].

Business activity for non-charitable purpose and there was no material to hold that such business was carried on by the assessee as means in the course of the actual carrying out of the main or primary object. [*CIT v Virudunagar Hindu Nadars Abiviruthi Panchukadai Mahamai* (1996) 219 ITR 303 (Mad)].

Settlement for settlor's poor relations is not a settlement for charitable purpose. [*Trustees of Gordhandas Govindram Family Charity Trust v CIT* (1968) 69 ITR 750 (All)].

Exemption u/s 11 was denied on the ground that association was to work for common benefits of members who were traders in cement and there was no intention to benefit general public or any section of general public. Merely because the objects stated that it shall not function for profit, will not make it exempt. [*CIT v Ernakulam Distt. Cement Dealers Association* (2001) 119 Taxman 871 (Ker)].

Religious trust

Religious purposes would include the advancement, support or propagation of a religion and its tenets. So, a trust made for any of these purposes is said to be a religious trust. However, sections 11, 12 and 13 make a distinction between charitable and religious trusts. A charitable trust must always be public, but a religious trust may be private or public.

Exemption not allowed to private religious trust for that part of income which does not enure for the benefit of public

The exemption granted by section 11 is confined to public religious trusts and does not extend to private religious trusts, which do not enure for the public benefit. This is made clear by section 13(1)(a) which provides that nothing contained in section 11 shall operate to exempt *any part* of the income from the property held under a trust for private religious purposes which does not enure for the benefit of the public.

Which income will be exempt under section 11

Subject to the provisions of sections 60 to 63, the following incomes of a religious or charitable trust or institution are not included in its total income, provided the above conditions are satisfied:

(a) Income from property held under trust wholly for charitable or religious purposes [*Section 11(I)(a)*]: Income derived from property held under trust *wholly* for charitable and religious purposes, shall be exempt—

- (i) to the extent such income is applied in India for such purpose; and
- (ii) where any such income is accumulated or set apart for *application to such purposes in India*, to the extent to which the income so accumulated or set apart *is not in excess of 15% of the income from such property*; (25% upto assessment year 2002-03).

(b) Income from property held under trust which is applied in part only for charitable or religious purposes [*Section 11(I)(b)*]: Income derived from property held under trust *in part* only for *such purpose*, shall be exempt:

- (i) to the extent such income is applied in India for *such purposes*, provided, the trust in question is *created before the commencement of Income-tax Act, 1961 i.e. before 1-4-1962*; and
- (ii) where any such income is *finally set apart* for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of 15% of the income from such property (25% upto assessment year 2002-03).

(c) Income from property held under trust which is applied for charitable purposes outside India [*Section 11(I)(c)*]:

- (i) Income derived from property held under trust, *created on or after 1-4-1952 for charitable purpose* which tends to *promote international welfare in which India is interested*, shall be exempt to the extent to which such income is applied to such purpose outside India. Religious trusts are not covered here.
- (ii) Income derived from property held under a trust for *charitable or religious purposes*, created before 1-4-1952, shall be exempt to the extent to which such income is

applied to such purposes outside India.

In the above two cases, it is necessary that the Board, by general or special order, has directed in either case that it shall not be included in the total income of the person in receipt of such income.

(d) Voluntary contributions forming part of corpus [Section 11(I)(d)]: Income in the form of voluntary contributions made with a specific direction, that they shall form part of the corpus of the trust or institution, shall *be fully exempt*. The condition that at least 85%¹ of the income should be applied during the previous year in which it is earned is not applicable in this case.

- (1) *Voluntary Contributions not forming part of corpus shall be deemed income (Section 12):* Voluntary Contributions received by a trust/ institution created wholly for charitable or religious purposes (not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution) shall *be deemed to be income* derived from *property held under trust wholly for charitable or religious purposes* and the provision of section 11 (including the application of atleast 85%² of income) and the provision of section 13 shall apply accordingly. Thus as per *Explanation 1* to section 11 in computing the 15%³ of income which may be accumulated or set apart, such voluntary contributions, shall be deemed to be part of the income. It may be noted that *if such voluntary contributions are received by a trust created partly for charitable or religious purposes, the exemption shall not be available.*
- (2) Section 11 provides for exclusion of income of a trust subject to the provision of sections 60 to 63. Therefore, before excluding any portion of the trust income from charge on the ground that it belongs to a charitable or religious trust, it is necessary first of all, to find that the income in question is includible in the total income of the trust. For, if any income though received by the trust, is includible in the total income not of the trust, but of another person, then no question of the exclusion or exemption arises in respect of that income on the ground of its belonging to a trust for charitable or religious purposes. For instance, where property is settled in trust but the settlement is by way of a revocable transfer, then, the income arising out of such property is chargeable in the hands of the settlor under section 61. The group of section 60 to 63 deals with the subject. When income is so assessed in hands of the settlor by virtue of the operation of the said sections, it will bear full tax without any exemption in the hands of the settlor.
- (3) "Property held under trust" includes a business undertaking so held and income of such business has necessarily to be applied for charitable or religious purpose as directed in the trust deed.

Exemption is limited to the extent such income is applied for charitable or religious purposes: It has been mentioned above, that exemption for clauses (a), (b) and (c) is limited to the extent to which such income is *applied in India* [or outside India in case of clause (c) mentioned above].

Although, the exemption for clauses (a) and (b) is available to the extent income is applied during the previous year for charitable or religious purposes but it is not necessary that 100% of the income should be so applied for such purposes during the previous year itself to claim full exemption.

As per the Act, for claiming full exemption of such income, the assessee is *required to apply atleast 85%*⁴ of such income during the previous year for charitable or religious purposes. He can accumulate upto 15%⁵ of such income to be utilized for charitable or

¹ 75% upto assessment year 2002-03.

² 75% upto assessment year 2002-03.

³ 25% upto assessment year 2002-03.

⁴ 75% upto assessment year 2002-03.

⁵ 25% upto assessment year 2002-03.

religious purposes in India at a later date. Such facility of accumulation is not available for trust mentioned in clause (c) above, whose income is to be applied outside India and as such these trusts will be allowed exemption only to the extent the amount has been applied for such purposes outside India.

1. After 28-2-1983, 15% of the income, which can be accumulated or set apart for any period, should also be invested or deposited in one or more of the forms or more specified in section 11(5).
2. Although the trust or institution is required to apply at least 85% of income, and accumulate maximum 15% of income, but it can accumulate *even more than* 15% of such income in certain cases and subject to certain conditions mentioned in section 11(2) discussed later.

Judicial decision

1. In the relevant year the assessee trust received donations of Rs. 2,57,376 out of which it applied Rs. 1,70,369 for its charitable purposes, leaving a balance of Rs. 87,010. The question before the Supreme Court was whether the assessee is entitled to accumulate under section 11(1)(a) 25% (reduced to 15% w.e.f. A.Y. 2003-04 by the Finance Act, 2002) of Rs. 2,57,376 as it contends or 25% of Rs. 87,010 as revenue contends.

The Supreme Court held that on the plain language of section 11(1)(a) of the Act, the assessee was entitled to accumulate 25% of Rs. 2,57,376 and not merely 25% of the balance of Rs. 87,010. [*CIT v Programme of Community Organisation* (2001) 248 ITR 1 (SC)].

In other words, excepting trust mentioned in clause (c) above, even if 85% of the income is applied for charitable or religious purposes during the previous year, the assessee can claim 100% exemption of the income earned during the previous year provided the balance income, not exceeding 15%, is accumulated to be utilized for charitable and religious purposes at a later date.

2. Agricultural income will not form part of total income for the purpose of computing the accumulation of income in excess of 25 per cent (now 15%) of the total income as laid down under section 11 of the Income-tax Act, 1961. [*CIT v Nabhinandan Digamber Jain* (2002) 257 ITR 91 (MP)].

Income applied during the previous year includes the following: It is clear from the above discussion that for claiming full exemption at least 85% of the income should be *applied* during the previous year, towards the purpose for which the trust has been created. Income *applied* during the previous year for this purpose includes the following:

- (a) income *actually* applied *during the previous year* for charitable and religious purposes,
- (b) income *deemed to have been applied* for charitable or religious purposes in India *during the previous year*.

Income deemed to have been applied during the previous year for charitable or religious purposes [Explanation 2 to section 11(1)]

If the income applied to charitable or religious purposes during the previous year falls short of 85% of the income derived during the year either:

- (a) for the season that whole or part the income has not been received during the previous year or
 - (b) for any other reason,
- then the charitable trust has been given the option to spend such income for charitable or religious purposes in the following manner:

- (i) In case of (a) either during the previous year in which the income is so received or in the immediately following previous year. Example, if the income of previous year 2002-03 is received on 15-4-2003, *i.e.*, next year, such income should be applied for charitable or religious purposes either during previous year 2003-04 and/or 2004-05.
- (ii) In case of (b) during the previous year immediately following the previous year in which the income was derived. If the income is received on 28-3-2003 and it could not be spent in the previous year 2002-03 for any reason, it could be applied in the next previous year *i.e.* 2003-04.

To avail the facility of the above extended period of application of income, the *trust has to exercise an option in writing*.

If such option is exercised by the trust, such income shall be deemed to have been applied for charitable and religious purposes during the previous year in which the income is earned, though it is actually spent at a later date. In this case, as such income is deemed to have been applied during the previous year in which it was derived, it shall not be treated as application of income for charitable purposes, of the previous year in which it is actually spent.

Illustration for reason (a)

During the previous year 2002-03 a charitable trust earned an income of Rs. 5,00,000 out of which Rs. 4,00,000 was received during the previous year 2002-03 and the balance Rs. 1,00,000 was received during the previous year 2003-04. To claim full exemption of Rs. 5,00,000 in the previous year 2002-03, state:

- (i) What is the maximum amount which can be accumulated to be utilized for charitable or religious purposes at a later date.
- (ii) How much amount should be actually spent during the previous year 2002-03.
- (iii) How much amount will be deemed to be utilized during the previous year 2002-03 and within what time should it be actually utilized.

Solution

	Rs.
Total income earned	5,00,000
Accumulation allowed @ 15%	75,000
Balance to be utilized during the year	4,25,000
Amount which may be deemed to be utilized because it has not been received during the previous year	1,00,000
Therefore, amount to be actually applied during the previous year	3,25,000
Rs. 1,00,000 received during the previous year 2003-04 should be actually utilized either during the previous year 2003-04 or previous year 2004-05	

Ans. (i) Rs. 75,000; (ii) Rs. 3,25,000; (iii) Rs. 1,00,000 to be actually utilised till 2004-05.

Illustration for reason (b)

During the previous year 2002-03 a charitable trust earned an income of Rs. 5,00,000. Out of this an income of Rs. 1,00,000 was received on 29-3-2003. Although the amount of Rs. 1,00,000 has been received during the previous year 2002-03 itself, but it may not be possible to spend such amount within the previous year as it has been received on 29-3-2003. Therefore, it has been provided, that such sum can be applied at any time during the immediately following previous year *i.e.*, upto 31-3-2004. If the amount is so utilized during the immediately following previous year, it shall be deemed to have been utilized in the previous year 2002-03 itself.

Procedure for exercise of option: For claiming the above benefit, the trust has to exercise an option in writing that such income may be deemed to be income applied to the relevant charitable purpose during the previous year in which the income was derived. Such option has to be exercised before the expiry of the time allowed u/s 139(1) for submission of returns.

The definition of income in section 2(24) includes capital gain. Hence, the option exercisable by a charitable trust with regard to income under the provisions of section 11(1) can also be exercised in respect of capital gains, provided it is exercised in writing before the expiry of the time allowed under section 139(1) for furnishing the return. [*CIT v East India Charitable Trust* (1994) 206 ITR 152 (Cal)].

The Bombay High Court has held that even if the return of income is filed after the due date as given in section 139(1), if the same is filed within the time specified in section 139(4) and the option contemplated by *Explanation* (2) to section 11(1) is exercised in writing along with such return, the requirements of the *Explanation* would stand satisfied. [*Trustees of Tulsidas Gopalji Charitable and Chaleshwar Temple Trust v CIT* (1994) 207 ITR 368 (Bom)].

Consequences if the income is not actually applied within the prescribed period after exercising the option [Section 11(1B)]: Where the income for which an option has been exercised by the assessee is not actually applied within the prescribed time, it shall be treated as the income of the previous year immediately following the year of receipt, in case of reason (a). In the above illustration if income of Rs. 1,00,000 is not applied till 31-3-2005 it will be treated as the income of previous year 2004-05.

In case of reason (b) it will be treated as the income of the previous year immediately following the previous year in which such income was derived. Similarly in the above illustration given for reason (b) if Rs. 1,00,000 is not applied till 31-3-2004 it will be treated as income of previous year 2003-04.

Mode of computation of income of a trust: The income from the properties held under trust have to be arrived at in the normal commercial manner without classification under the various heads set out in section 14 of the Income-tax Act, 1961. The expression "income" has to be understood in the popular or general sense and not in the sense in which the income is arrived at for the purpose of assessment to tax by application of some artificial provisions either giving or denying deduction. *The computation under the different categories or heads arises only for the purposes of ascertaining the total income for the purposes of charge. Those provisions cannot be introduced to find out what the income derived from the property held under trust to be excluded from the total income is, for the purpose of the exemptions under Chapter III.* The amount of depreciation debited to the accounts of the charitable institution has to be deducted to arrive at the income available for application to charitable and religious purposes. [*CIT v Sheth Manilal Ranchhoddas Vishram Bhavan Trust* (1992) 198 ITR 598 (Guj)]. **See also** *CIT v Bhoruka Public Welfare Trust* (1999) 240 ITR 513 (Cal)].

Tax deducted at source: Section 11 cannot be interpreted to mean that the amount which has been deducted at source by way of there tax shall be included in the income of the trust, the income which has been *actually received* shall be applied for charitable purposes to claim exemption under section 11. [*CIT v Jayashree Charity Trust* (1986) 159 ITR 280 (Cal)].

Meaning of "Applied": Applied, in this context, means that the income is actually applied for the charitable or religious purposes of the trust. [*H.E.H. Nizams Religious Endowment Trust v CIT* (1966) 59 ITR 582, 588 (SC)]. The word applied need not necessarily imply spent. Even if an amount is irretrievably earmarked and allocated for the charitable or religious purpose(s). [*CIT v Radhaswami Satsang Sabha* (1954) 25 ITR 472, 522-3 (All); *CIT v H.E.H. The Nizams Charitable Trust* (1981) 131 ITR 497, 501-02 (AP)]. A mere credit entry in the books of the trust in the expectation of future income is not sufficient [*Nachimuthu Industrial Association v CIT* (1980) 123 ITR 611 (Mad)] but a credit entry made to allocate already earned income followed by some payments made in the year was held proper

application. [*CIT v Thanthi Trust* (1982) 137 ITR 735 (Mad)].

It is not necessary that in order to treat any amount as 'application' within the meaning of these provisions, the particular amount should be spent for charitable purposes only after the trust has earned profits.

Application of income may not result into revenue expenditure: Where income is applied for purchase of a capital asset, it would still be application of income to the charitable purpose. If the assessee invests in construction of a building, which is a permissible investment under section 11(5) of the Income-tax Act, so as to augment its resources for fulfilling the objectives of the institution, there is no doubt that such outlay would qualify as income applied for charitable purposes. [*CIT v St. George Forana Church* (1988) 170 ITR 62 (Ker)].

Repayment of a debt incurred for charitable purposes by a charitable trust and loans advanced by educational trusts Application of income: Section 11 of the Income tax Act requires 100% of the income of a charitable and religious trust to be applied for religious and charitable purposes to be entitled to the exemption under the said section. Two questions have been considered regarding the application of income:

- (i) Where a trust incurs a debt for the purposes of the trust, whether the repayment of the debt would amount to an application of the income for the purposes of the trust? And
- (ii) Whether loans advanced by an educational trust to students for higher studies would be treated as application of income for charitable purposes?

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. As regards the loans advanced for higher studies, if the only object of trust is to give interest-bearing loans for higher studies, it will amount to carrying on of money- lending business. If, however, the object of the trust is advancement of education and granting of scholarship loans as only one of the activities carried on for the fulfilment of the objectives of the trust, granting of loans, even interest-bearing, will amount to the application of income for charitable purposes. As and when the loan is returned to the trust, it will be treated as income of that year. [Circular No. 100, dated 24-1-1973].

Repayment of loan taken for construction of a building shall qualify as income applied for charitable purpose. [*CIT v Janamabhumi Press Trust* (2000) 242 ITR 703 (Kar)].

Payment of taxes held application: Expenditure by way of payment of tax out of current year's income has to be considered as application for charitable purposes because the payment has been made to preserve the corpus, the existence whereof is essential for the trust itself. [*CIT v Janaki Ammal Ayya Nadar Trust* (1985) 153 ITR 159 (Mad)].

Donation by one charitable trust to another amounts to application: When a charitable trust donates its income to another charitable trust, the provisions of section 11(1)(a) can be said to have been met by the donor-trust and the donor-trust can be said to have applied its income for charitable and religious purposes. However w.e.f. assessment year 2003-04, any donation made out of income accumulated or set apart either during the period of accumulation or thereafter to any trust or institution registered under section 12AA or to any fund, institution or trust or any university or other education institution or any hospital or other medical institution referred to in section 10(23C)(iv), (v), (vi) or (via) shall not be treated as application of income for charitable or religious purposes.

It has been decided by the Board that as the law stands at present, the payment of a sum by

one charitable trust to another for utilisation by the donee-trust towards its charitable objects is proper application of income for charitable purpose in the hands of the donee-trust; and the donor-trust will not lose exemption under section 11 of the Income tax Act 1961, merely because the donee-trust did not spend the donation during the year of receipt itself. [Extracted at (1988) 172 ITR 709 (Guj)].

Other cases of application: Other cases holding that in the facts of those cases, the expenditure or outgoing did constitute application of income for charitable purposes, are:

- (1) *CIT v Kannika Parameswari Devasthanam & Charities* (1982) 133 ITR 779 (Mad) [capital expenditure incurred on improving or maintaining property of the trust].
- (2) Application of surplus funds in construction of additional buildings with the purpose of letting them out and utilising the rent for the objects of the trust would amount to applying funds for religious and charitable purposes. [*St. George Forana Church* (1988) 170 ITR 62 (Ker)].
- (3) Spending on production and exhibition of a film, as also spending for the construction of a overhead tank on land belonging to the legal heirs of the founder of the assessee-trust is application. [*CIT v Divine Light Mission* (1990) 183 ITR 56 (Del)].
- (4) Expenditure on salaries and miscellaneous expenses for the purpose of carrying out the objects and purposes of the trust must be considered as application for charitable purposes. [*CIT v Birla Janahit Trust* (1994) 208 ITR 372 (Cal)].
- (5) Where the assessee is a charitable institution, legal expenses incurred by the assessee-association for defending the persons running the association against criminal charges are allowable as a permissible deduction while computing the total income of the assessee association. [*Ananda Marga Pracharaka Sangha v CIT* (1994) 76 Taxman 88 (Cal)].
- (6) Income for the purposes of section 11 should be understood in its commercial sense and, therefore, loss on sale of shares to make investments in specified investments within the meaning of section 11(5) has to be treated as application of income of the trust. [*Chidambaram Chettiar Foundation v ITO* (1991) 39 TTJ 82 (AT)(Mad)].

Excess expenditure in an earlier year may be set off against next year's income: In *CIT v Maharana of Mewar Charitable Foundation* [(1987) 164 ITR 439 (Raj)] the trust had spent in excess of its income for the current year resulting in a deficit which was carried forward to the next year. It was held that in considering the application of income for the next year, the carried forward deficit was first to be set off against the income of the subsequent year.

When a trust had spent in excess of its income for the current year resulting in a deficit which was carried forward to the next year, it was held that in considering the application of income for the next year, the carried forward deficit was first to be set off against the income of the subsequent year. [*CIT v Maharana of Mewar Charitable Foundation* (1987) 164 ITR 439 (Raj)].

Cases where income held not applied

(1) However, investment in immovable property by accepting the immovable property in satisfaction of outstanding amounts was held as not an application of income but mere change of investment. [*CIT v S.R.M. CT. M. Thiruppani Trust* (1982) 134 ITR 55 (Mad)].

(2) If a part of the income of a trust is applied to pay monthly remuneration to one of the settlors for services rendered, it may not be an application for the purposes of the trust but normal expenditure of the conduct of the trust and would be deductible in arriving at the

income available for application. [*CIT v Divekar Charity Trust* (1977) 110 ITR 227 (Bom)].

Accumulation of income in excess of 15%¹ of the income earned [Section 11(2) and Rule 17]

As already mentioned, assessee is allowed to accumulate upto 15% of the income earned during the year for application for charitable or religious purposes in India in future. If the assessee wants to accumulate or set apart the income in addition to 15% of the income, he can do so if certain conditions are satisfied. In this case, the amount accumulated in excess of 15% shall be treated to have been applied for charitable or religious purposes in India during the previous year itself.

Conditions to be satisfied:

(1) Such assessee should give a notice, in writing, in the prescribed form [F. No. 10] and manner, to the Assessing Officer specifying:

- (a) the purpose for which the income is being accumulated or set apart;
- (b) the period for which the income is to be accumulated or set apart. Such period should not exceed 5 years (10 years upto 31-3-2001) in any case.

However, in computing the period of 5 years (10 years upto 31-3-2001), the period during which the income could not be applied for the purpose for which it is so accumulated or set apart due to an order or injunction of any court, shall be excluded.

The notice in Form 10 should be delivered to the Assessing Officer before the expiry of time allowed u/s 139(1) for filing the return of income. [Rule 17]

The Commissioner can however condone the delay in furnishing this notice in terms of Circular No. 273, dated 3-6-1980. The CIT will, while entertaining such applications, satisfy himself that certain conditions mentioned in the said circular are fulfilled.

However, it has been held that part of rule 17 which deals with limitation of time for filing Form No. 10 is clearly beyond section 11(2)(a) and is therefore illegal.

The application in Form No. 10 can be filed even after the assessment is completed. [*Nagpur Hotel Owners Association* (2001) 247 ITR 201 (SC)].

While the section or the rule does not prescribe any time limit for making the investments as referred to in section 11(2)(a), paragraph (2) of Form No. 10 states that such investments are to be made before expiry of six months from the end of the previous year. This paragraph (2) in Form No. 10 has been struck down as *ultra vires* in that the rule making authority had exceeded its limits in including in the form the said paragraph. Paragraph (4) in Form No. 10 was also struck down as *ultra vires* as the prayer contained therein is made conditional on the assessee complying with the time limits prescribed in paragraph (2). [*Teckchand Chandiram Trust* (1990) 184 ITR 537 (Bom)].

(2) The money so accumulated or set apart should be invested or deposited in the form or mode specified in section 11(5).

Mode of investment.—Section 11(5) specifies the following modes of deposit/investment:

- (1) Investment in Government Saving Certificates and any other Securities or Certificates issued by the Central Government under its Small Saving Scheme.
- (2) Deposits with Post Office Savings Banks.
- (3) Deposits with Scheduled Banks or Co-operative Banks (including a Cooperative Land Mortgage Bank or a Cooperative Land Development Bank).

¹ 25% upto assessment year 2002-03.

- (4) Investments in the units of Unit Trust of India.
- (5) Investments in Central or State Government Securities.
- (6) Investments in debentures issued by or on behalf of any company or corporation. However both the principal and interest thereon must have been guaranteed by the Central or the State Government.
- (7) Investment or deposits in any public sector company.

An investment or deposit in a public sector company shall continue to be one of the eligible modes of investment for charitable or religious trusts, for a period of three years (in the case of shares), and till the date of maturity of other investment or deposit from the date a public sector company ceases to be a public sector company.

- (8) Investment in bonds of approved financial corporation providing long term finance for industrial development.
- (9) Investment in bonds of approved public companies whose principal object is to provide long-term finance for construction or purchase of houses in India for residential purposes.
- (10) Investment in immovable property excluding plant and machinery, not being plant and machinery installed in a building for the convenient occupation thereof.
- (11) Deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation. For the purposes of this clause,—

- (a) long-term finance means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;
 - (b) public company shall have the meaning assigned to it in section 3 of the Companies Act, 1956;
 - (c) urban infrastructure means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport.
- (12) Deposits with the Industrial Development Bank of India.
 - (13) Any other form or mode of investment or deposit as may be prescribed.

Prescribed Forms or modes of investment or deposit by a charitable or religious trust or institution (Rule 17C): As per rule 17C the following forms and modes of investments or deposits *have been prescribed*:

- (i) investment in the units issued under any scheme of mutual fund referred to in section 10(23D) of the Income tax Act, 1961;
- (ii) any transfer of deposits to the Public Account of India;
- (iii) deposits made with an authority constituted in India by or under any law enacted either for the purpose of dealing with any satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both.
- (iv) investment by way of acquiring equity shares of a depository as defined in section 2(1)(e) of the Depositories Act, 1996.

Donation to other institution out of accumulated income not to be treated as application of income for charitable/religious purpose: An *Explanation* to section 11(2) has been inserted to provide that any amount credited or paid out of the income which is not applied, but is

accumulated or set apart to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in section 10(23C)(iv), (v), (vi) and (via) shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

Amendment made by the Finance Act, 2003 (W.r.e.f. A.Y. 2003-04)

Finance Act, 2003 has inserted a second proviso to section 11(3A) to provide that the Assessing Officer may allow application of such income by way of donation to another trust in the year in which such trust or institution *is dissolved*.

Consequences if such accumulated income in excess of 15%¹ is not applied/invested in the prescribed manner [Section 11(3)]: Where the income of the trust referred to in section 11(2)—

- (a) is applied for purposes other than charitable or religious purposes, or
- (b) ceases to be accumulated or set apart for application thereto, or
- (c) ceases to remain invested or deposited in any mode mentioned under section 11(5) above, or
- (d) is not utilized for the purpose for which it is so accumulated or set apart during the period specified (not exceeding 10/5 years) or in the year immediately following thereof.

- (e) is credited or paid to any trust or institution registered under section 12AA or any institution or trust referred to in section 10(23C)(iv), (v), (vi) or (via),

such income shall be deemed to be the income,—

in case of (a) of the previous year in which it is so applied, or

in case of (b) of the previous year in which it ceases to be accumulated or set apart, or

in case (c) of the previous year in which it ceases to remain so invested or deposited, or

in case of (d) of the previous year immediately following the expiry of period specified therein, or

in case of (e) of the previous year in which it is paid or credited.

However, in computing the aforesaid period of 10/5 years, the period during which the income could not be applied for the purposes for which it is so accumulated or set apart due to an order or injunction of any Court, shall be excluded.

The legal fiction contained in section 11(3) should be allowed full play without taking a narrow view for denying exemption. Accordingly, where accumulated income ceased to be invested in fixed deposit and was consequently deemed to be income of the trust by virtue of section 11(3), the assessee was held to be entitled to accumulate 25% (now 15%) of the total income including the deemed income under section 11(3). [*CIT v Natwarlal Chowdhury Charity Trust* (1991) 189 ITR 656 (Cal)].

Circumstances where the accumulated income in excess of 15%² can be utilized for a purpose other than that for which it was accumulated [Section 11(3A)]: Where the income invested/deposited in approved modes cannot be applied for the purposes for which it was

¹ 25% upto assessment year 2002-03.

² 25% upto assessment year 2002-03.

accumulated or set apart, due to circumstances beyond the control of the assessee, such assessee can make an application to the Assessing Officer specifying such other purpose for which he wants to utilize such accumulated income. Such other purposes should also be in conformity to the objects of the trust. The Assessing Officer in this case, may allow the application of such income to such other purposes. However, the Assessing Officer shall not allow application of such income by way of payment or credit made for donation to other trust or other institutions.

Certain points for consideration

(1) Voluntary contribution: Voluntary contribution can be of two types:

- (a) *Voluntary contribution with a specific direction that they shall form part of the corpus of the trust or institution:* Such voluntary contributions received by the trust are fully exempt under section 11 and the condition that at least 85% of the income should be applied during the previous year in which it is earned is not applicable in this case.
- (b) *Voluntary contributions not being contributions made with a specific direction that they shall form part of the corpus of the trust/institution:* Such contributions are covered u/s 12 and shall be deemed to be income derived from property held under trust wholly for charitable or religious purposes. Exemption of such contribution shall be allowed in the same manner as is allowed for income derived from property held under trust in section 11 and all the conditions including 85% of income to be applied in the same previous year as given above are applicable in this case.

(2) Exemption under section 11(1) not to be allowed in the following cases

(a) Notwithstanding the exemption available under section 11(1), if the charitable or religious trust is running a hospital or medical institution or an educational institution and makes available medical or educational services to any person referred to in section 13(3), the value of such services shall be deemed to be income of such trust and chargeable to income tax.

Explanation.—The expression 'value' shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person mentioned in section 13(3), clauses (a) to (d).

(b) Notwithstanding anything contained in section 11, any amount of donation received by the trust or institution in terms of section 80G(2)(d) which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of section 80G(5C) and not transferred to the Prime Minister's National Relief Fund on or before 31-3-2003, shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

(3) Treatment of Capital gain in case of Charitable Trusts: Any profit or gain arising from the transfer of capital asset being property held under trust shall be treated as capital gain. Since such capital gain, whether short-term or long-term, is also part of the income as per section 2(24), to claim exemption under section 11 the Charitable Trust should also apply income from such capital gain for charitable purposes during the previous year like any other income. It means that trust shall have to apply atleast 85%¹ of the income from such capital gain for charitable purposes during the previous year subject to exception given under section 11(2).

¹ 75% upto assessment year 2002-03.

Cases where income from capital gain shall be deemed to have been applied for charitable purposes [Section 11(IA)]

- (A) *Transfer of capital asset held under trust wholly for charitable or religious purposes*
 Section 11(IA)(a): Where any capital asset being property held under trust wholly for charitable or religious purposes is transferred, and the whole or part of the net consideration is utilized for acquiring another capital asset to be so held, then, the capital gain arising from such transfer shall be deemed to have been applied to charitable purposes to the extent specified hereunder:
- (i) Where the *whole* of the net consideration of such asset is utilized in acquiring a new capital asset, the whole of the capital gain shall be deemed to have been applied to charitable or religious purposes.
- (ii) Where *only a part* of the net consideration is utilized for acquiring the new capital asset, so much of such capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset, shall be deemed to have been applied to charitable or religious purposes.

Example:

	Rs.
Cost of Asset transferred	5,00,000
Net consideration of the Asset transferred	8,00,000
Cost of new capital Asset acquired	
(a)	8,00,000
(b)	7,00,000
(c)	6,00,000

In the above cases, the capital gain is Rs. 3,00,000 and the following amount shall be deemed to have been applied for charitable or religious purposes thus exempt:

- (a) Rs. 3,00,000 (Amount invested — Cost of Asset)
 (b) Rs. 2,00,000 (Amount invested — Cost of Asset)
 (c) Rs. 1,00,000 (Amount invested — Cost of Asset)

Exemption of balance capital gain in case of (b) and (c) above can also be claimed on satisfying the condition regarding application and accumulation.

- (B) *Transfer of capital asset held under trust in part only for charitable or religious purposes [Section 11(IA)(b)]*

As already discussed, such trusts are eligible for exemption under section 11 only when they have been created before the commencement of the Income-tax Act, 1961.

Where capital assets being a property held under trust in part only for such purposes is transferred, the treatment of capital gains shall be as under:

- (i) where the whole of the net consideration is utilized in acquiring the new capital asset, then the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied for the charitable or religious purposes.
- (ii) in any other case, the exemption shall be limited to so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilized for acquiring the new capital assets, exceeds the appropriate fraction of the cost of the transferred asset.

Appropriate fraction means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes;

Cost of the transferred asset means the aggregate of the cost of acquisition (as ascertained for the purposes of section 48 and 49) of the capital asset which is the

subject of the transfer and the cost of any improvement thereto within the meaning assigned to that expression in section 55(1)(b);

Net consideration means the full value of the consideration received or accruing as result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

Example

An asset is held under trust and 60% of the income derived from such capital asset is being utilized for charitable or religious purposes.

	Rs.
Cost of the asset transferred	5,00,000
Net consideration of transferred asset	8,00,000
Cost of new asset	
(a)	8,00,000
(b)	6,00,000

Solution

Appropriate fraction is 60%

Case (a)

	Rs.
Capital gain	3,00,000
Appropriate fraction of capital gain (60% of Rs. 3,00,000)	1,80,000
Therefore Rs. 1,80,000 shall be deemed to have been applied for charitable purposes and thus exempt	

Case (b)

Appropriate fraction of amount utilized (60% of Rs. 6,00,000)	3,60,000
Appropriate fraction of cost (60% of Rs. 5,00,000)	3,00,000

Therefore amount deemed to be utilised for charitable purposes shall be appropriate fraction of amount utilized minus the appropriate fraction of cost *i.e.*, Rs. 3,60,000 - Rs. 3,00,000 = Rs. 60,000.

The exemption of balance capital gain of Rs. 1,20,000 can also be claimed on satisfying the condition regarding application and accumulation.

Investment by way of deposit in a public sector company can be treated as a new asset acquired with the net consideration in terms of section 11(1A) [*CIT v East India Charitable Trust* (1994) 206 ITR 152 (Cal)].

Net consideration invested in a fixed deposit is an investment for acquiring another capital asset. [*Hindustan Welfare Trust v ITO* (1988) 26 ITD 1 (AT) (SB) (Cal)].

Where an assessee trust had used the consideration on sale of a capital asset for redeeming a pledge, it was held that the assessee trust had merely discharged its obligation to pay the creditor and had not thereby acquired any capital asset so as to be entitled to the exemption under this section. [*CIT v Avkash Nidhi* (1986) 160 ITR 729 (Guj)].

Where an assessee sold some shares and a part of the net consideration was deposited in a bank and the balance was left with the purchaser of shares as fixed deposit on interest and in its balance sheet this amount was shown as investment, it was held that the provisions of section 11(1A) were fully satisfied. [*CIT v Ambalal Sarabhai Trust* (1988) 173 ITR 683 (Guj)].

Investment of the net consideration in fixed deposit with a bank for a period of six months or above would be regarded as utilization of the net consideration for acquiring another capital asset within the meaning of section 11(1A) of the Income-tax Act, 1961. [Instruction No. 883, dated 24-9-1975].

Where the net consideration was utilised during the accounting year for acquiring units of Unit Trust of India but the certificates of the units were received after the expiry of the accounting year, it was held that if the investments were actually made during the accounting year, the issue of the units by the Unit Trust of India after the expiry of the accounting year is immaterial for the purpose of claiming exemption under section 11(1A). [*CIT v East India Charitable Trust* (1994) 206 ITR 152 (Cal)].

Section 11(1A) is not meant for calculation of capital gains tax but is to operate after capital gains are worked in accordance with the provisions of sections 45 to 55. [*Akhara Ghamanda Dass v Asst. CIT* (2000) 68 TTJ (Asr) 244.

Treatment of business income of a trust [Section 11(4A)]

Where a trust or an institution is also carrying on any business activity, the provisions of sections 11(1), (2), (3) and (3A) regarding exemption etc. shall not apply in respect of income earned from such business activity. However, if such business is incidental to the attainment of the objects of the trust/institution and separate books of accounts are maintained by such trust/institution in respect of such business, the exemption shall be available to trust in respect of income earned from such business activity.

Further, according to section 11(4), for the purpose of section 11 "property held under trust" includes a business undertaking so held and where a claim is made that the income of any such undertaking shall not be included in the total income of the trust, etc in receipt thereof, the Assessing Officer shall have the power to determine the income of such incidental business in *accordance with the provision of the Income-tax Act* relating to the assessment and where the income determined by the Assessing Officer *exceeds the income as shown in the books of accounts* of the undertaking, such excess shall be deemed to be applied to purposes *other than* charitable or religious purposes and hence would not be exempt.

Section 11(4) is merely intended to tax income which is not accounted for in the books: it does not operate to charge a disclosed amount which is admittedly expended, for a purpose either charitable or non-charitable, but is disclosed as business expenditure and consequently added back in computing the business income. [*CIT v Birla Education Trust* (1985) 153 ITR 579 (Cal)].

1. Income of any other business which is not incidental to the attainment of the objectives of the trust or institution will not be exempt from tax. [Circular No. 642, dated 15-12-1992].
2. It is relevant to note that the provisions of section 11(4A) do not override the provisions of section 10 of the Income tax Act, and as such, profits derived by any trust, institution, association etc. referred to in clauses (21), (23A), (23B), (23BB), (23C), etc. will continue to be exempted from income tax.

Registration of Trust (Section 12A and Rule 17A)

As already discussed, for claiming exemption under sections 11 and 12, the trust must be registered under the Income-tax Act.

Conditions as to registration of trusts and effective date of exemption: The person in receipt of income should make an application for registration of the trust/ institution in the prescribed form (Form No. 10A) and in the prescribed manner to the Commissioner of Income-tax before the expiry of a period of one year¹ from the date of creation of the trust or the establishment of the institution. If the application for registration is made within the prescribed time and the registration is granted under section 12AA, the provisions of section 11 and 12 shall apply from the date of creation of trust.

Condonation of delay in making application: Where such application is made after the expiry of the aforesaid period, the provisions of sections 11 and 12 shall apply in relation to

¹ Trust created before 1-7-1973 were required to apply for registration by 30-6-1973.

the income from the *date of creation of the trust only* if the Commissioner is, for reasons to be recorded in writing, satisfied that the person in receipt of the income was prevented from making the application before the expiry of the period aforesaid for sufficient reasons.

If the Commissioner is not so satisfied, the provisions of sections 11 and 12 shall apply only from the first day of the financial year, in which such application is made.

When the entire period of delay in making the application for registration has been satisfactory explained, for good cause, there cannot be any denial of the resultant benefit of the registration for such lost time. [*Ananda Marga Pracharaka Sangha v CIT* (1994) 76 Taxman 88 (Cal)].

Documents to be attached alongwith application in Form 10A: Application for registration in Form 10A shall be accompanied by the following documents, namely:—

- (a) (i) where the trust is created, or the instrument is established, under an instrument the instrument in original, together with one copy thereof
- (ii) where the trust is created, or the institution is established, otherwise than under an instrument the document evidencing the creation of the trust or the establishment of the institution, together with one copy thereof

However, if the instrument or document in original cannot conveniently be produced, it shall be open to the Chief Commissioner or Commissioner to accept a certified copy in lieu of the original;

- (b) where 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, two copies of the accounts of the trust or institution relating to such prior year or years (not being more than three years immediately preceding the year in which the said application is made) for which such accounts have been made up.

Where, on an application filed under section 12A(a), a trust or institution is registered as a charitable or religious one, the registration itself would be sufficient proof of the fact that the trust or institution concerned is created or established for charitable or religious purposes. In such a case, it would not be possible for the Assessing Officer, in the course of the assessment proceedings, to come to a different finding that the trust or institution is not one for charitable or religious purposes. However, the Assessing Officer would be entitled to forfeit the exemption to the trust or institution for non-fulfilment of any other statutory requirement and/or contravention of any other provision of law. [*CIT v Ootacamund Gymkhana Club* (1977) 110 ITR 392 (Mad)].

Procedure for registration (Section 12AA): The Commissioner, on receipt of an application for registration of a trust or institution made under section 12A, shall—

- (a) call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf; and
- (b) after satisfying himself about the objects of the trust or institution and the genuineness of its activities, he—
 - (i) shall pass an order in writing registering the trust or institution;
 - (ii) shall, if he is not so satisfied, pass an order in writing refusing to register the trust or institution,
 and a copy of such order shall be sent to the applicant:

However, no order refusing to register the trust shall be passed unless the

applicant has been given a reasonable opportunity of being heard.

(2) Every order granting or refusing registration shall be passed before the expiry of *six months* from the *end of the month* in which the application was received under section 12A.

Section 11 not to apply in certain cases (Section 13)

The following incomes of charitable or religious trusts/institutions shall not be eligible for exemption under sections 11 and 12.

- (1) *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 [Section 13(1)(a)].
- (2) *Any income* of trust/institution created/established for *charitable purposes* after 1-4-1962, if such trust or institution is created or established for the benefit of any particular religious community or caste [Section 13(1)(b)]. The exemption is however, available to a charitable trust or institution created or established before 1-4-1962 even if it is for the benefit of any particular religious community or caste.
- (3) *Any income of charitable or religious trust* or institution created or established after 1-4-1962, if under the terms of the trust or rules governing the institution, *any part of the income enures* directly or indirectly for the benefit of any person referred to in sub-section 13(3) [Section 13(1)(c)].
- (4) *Any income* of a trust for charitable or religious purposes or a charitable or religious institution (whenever created or established) if *any part of such income or any property of the trust* or the institution during the previous year is used or applied directly or indirectly for the benefit of any person referred to in section 13(3) [Section 13(1)(c)]. However, exemption is not denied where the trust, etc. is created before 1-4-1962 and such use or application of income is in compliance with a mandatory term of the trust or a mandatory rule governing the institution.

Charitable Trusts not to lose exemption if educational or medical facilities provided to specified persons: A new sub-section in section 13 has been inserted to provide that a trust running an educational institution or a medical institution or a hospital shall not lose the benefit of exemption of any income other than the value of benefits of educational or medical facilities provided to the specified persons, solely on the ground that such benefits have been provided to specified persons.

However, the value of such facilities provided to such specified persons either free of cost or at concessional rate shall be deemed to be income of such trust and shall not be eligible for exemption under section 11.

The expression "value" shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person referred to in clause (a) to clause (e).

- (5) Any income of a trust/institution, if its funds are invested/deposited otherwise than as specified u/s 11(5). [Section 13(1)(d)].

However, the above provisions of section 13(1)(d) shall not apply to the under mentioned:

- (i) any asset forming part of the corpus of the trust as on 1-6-1973;
- (ii) any accretion to the corpus shares by way of bonus shares allotted to the trust;
- (iii) debentures issued by or on behalf of any company or corporation and acquired by the trust before March 1, 1983;
- (iv) any asset not covered u/s 11(5) where such asset is held for not more than 1 year from the end of the previous year in which such asset is acquired;

- (v) any fund representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year 1984-85 or any subsequent assessment year. But such relaxation of the restriction will be denied unless the trust keeps separate accounts for the business. As already noted, subject to certain exceptions, such business profits no longer enjoy exemption under section 11.

A perusal of section 13 of the Income tax Act, 1961, makes it clear that it carves out an exception to section 11 or 12 by providing that in those cases which are covered by clauses (a), (b), (c) and (d), the provision of section 11 or 12 shall not operate. Broadly speaking, it is divided into three categories and an exception is carved out in the case of private religious trusts, charitable trusts and charitable or religious trusts if the conditions mentioned in clauses (a), (b), (c) and (d) are satisfied. Firstly, 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 is not to be excluded as provided under section 11 of the Act. Secondly, where a trust for charitable purposes or a charitable institution is created or established after the commencement of the Income tax Act, the authority is required to find out whether the trust for charitable purposes is established for the benefit of a particular religious community or caste. If it is so established, then the provisions of section 11 would not be applicable. Thirdly, clauses (c) and

(d) carve out an exception in the case of a trust for charitable or religious purposes or a charitable or religious institution. It provides certain cases in which any income thereof enures, used or applied, directly or indirectly, for the benefit of any person referred to in section 11(3) (now section 13(3)). In the three different clauses, namely, (a), (b) and (c) of section 13(1) the Legislature has used different phrases. Clause (a) deals with a trust for private religious purposes or a charitable or religious institution. From this different phraseology used by the Legislature in clauses (a), (b) and (c), it can be inferred that the Legislature intended to cover only trusts for charitable purposes under clause (b). That means, if a trust is composite, that is, for religious and charitable purposes, then it would not be covered. It is also apparent that if the trust is only for religious purposes, clause (b) would not be applicable. [*CIT v Barkate Saifiyah Society* (1995) 213 ITR 492 (Guj)].

The Andhra Pradesh High Court in the case of *CIT v Social Service Centre* (2001) 119 Taxman 124 held that donation to a church or construction of a church is not for a purpose, which is not of general public utility. The contention of the department that the expenditure on religious activities could not be given exemption was not accepted particularly in the context of the polity of our country. It was acknowledged by the Court that most of the religious and charitable activities go together in this country. After referring to the language of section 11, the High Court held that once an exemption is granted for charitable activities, the religious activities are also included.

Section 13(1)(c) provides that where a part of the income of a charitable or religious trust or institution enures or is used or applied, directly or indirectly, for the benefit of those persons specified in section 13(3), such a trust or institution shall forfeit the exclusion under section 11. Even if only a small portion of the income enures or is used or applied for the benefit of a person mentioned in section 13(3), the entire income of the trust is denied the exclusion, except in the case provided in section 13(4). [*CIT v Jammalal Bajaj Sewa Trust* (1988) 171 ITR 568 (Bom)].

However, w.e.f. assessment year 2002-03, as per section 13(6), if the charitable or religious trust is running a educational institution or a medical institution or a hospital, the exemption shall not be denied if the benefit of educational or medical facility is provided to the persons specified under section 13(3). In this case, only the value of such facility provided to such specified person shall be taxable.

Where a charitable institution gives temporary loan to another trust in pursuance of a direction by the donor agency, such a loan cannot be treated as a deposit or investment impermissible under section 11(5). Hence there is no infringement of terms of section 13(1)(d) read with section 11(5). [*Director of I.T. (Exemption) v Alarippu* (2000) 244 ITR 358 (Del)].

Persons referred to in section 13(3)

- (a) the author of the trust or the founder of the institution;
- (b) any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution at the end of the relevant previous year exceeds fifty thousand rupees;
- (c) where such author, founder or person is a Hindu undivided family a member of the family;
- (d) any trustee of the trust or manager (by whatever name called) of the institution;
- (e) any relative of any such author, founder, person, member, trustee or manager as aforesaid;
- (f) any concern in which any of the persons referred to in clauses (a), (b), (c) (d) and (e) has a substantial interest.

Meaning of substantial interest: For the purposes of this section, a person shall be deemed to have a substantial interest in a concern,

- (i) in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of the other persons referred to in sub-section (3);
- (ii) in the case of any other concern, if such person is entitled, or such person and one or more of the other persons referred to in sub-section (3) are entitled in the aggregate, at any time during the previous year, to not less than twenty per cent of the profits of such concern.

Meaning of relative: Relative, in relation to an individual, means—

- (i) spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) any lineal ascendant or descendant of the individual;
- (v) any lineal ascendant or descendant of the spouse of the individual;
- (vi) spouse of a person referred to in sub-clause (ii), sub-clause (iii), sub-clause (iv) or sub-clause (v);
- (vii) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.

When an income or property is deemed to have been used or applied for the benefit of a person referred to in section 13(3) [Section 13(2)]: Without prejudice to the generality of the provisions of clause (c) and (d) of section 13(1) the income or the property of the trust or institution or any part of such income or property is to be deemed to have been used or applied for the benefit of a person referred to in section 13(3) in the following cases:

- (a) *Interest free loan or loan without security:* If any part of the income or the property of the trust or institution is or continues to be lent to any person referred to in Section 13(3) for any period during the previous year without either adequate security or

- adequate interest or both. [Section 13(2)(a)].
- (b) *Use of properties without charging adequate rent:* If any land, building or other property of the trust or institution is or continues to be, made available, for the use of any person referred to in section 13(3) for any period during the previous year without charging adequate rent or other compensation. [Section 13(2)(b)].
 - (c) *Excessive payment for services:* If any amount is paid out of the resources of the trust or institution to any of the persons referred to in section 13(3) for services rendered to the trust or institution but such amount is in excess of a reasonable sum payable for such services. [Section 13(2)(c)].
 - (d) *Services of trust without adequate remuneration:* If the services of the trust or institution are made available to any person referred to Section 13(3) without adequate remuneration or other compensation. [Section 13(2)(d)].
 - (e) *Purchase of property for trust for excessive consideration:* If any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in section 13(3) during the previous year for a consideration which is more than adequate. [Section 13(2)(e)].
 - (f) *Sale of trust property for inadequate consideration:* If any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in section 13(3) during the previous year for a consideration which is less than adequate. [Section 13(2)(f)].
 - (g) *Diversion of income or property exceeding Rs. 1,000:* If any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in section 13(3) provided the aggregate value of such income and property diverted exceeds Rs. 1,000. [Section 13(2)(g)].
 - (h) *Investment in substantial interest concerns:* If any funds of the trust or institution are or continue to remain, invested for any period during the previous year (not being a period before the 1-6-1971) in any concern in which any person referred to in section 13(3) has a substantial interest. [Section 13(2)(h)].

However, section 13(4) provides that where the aggregate of the funds invested in the said concern does not exceed 5% of the capital of that concern, the exemption under section 11 will be denied only in relation to such income as arises out of the said investment.

Return of income of charitable trusts and institutions [Section 139(4A)]

Every person who is in receipt of the following income, if such income (computed before allowing any exemption u/s 11 and 12) exceeds the maximum amount not chargeable to tax, must file a return of income in respect of:

- (a) income derived from property held under trust or other legal obligation wholly or partly for religious or charitable purposes, or
- (b) income by way of voluntary contribution on behalf of such trust or institution.

The return of income must be furnished in Form No. 3A and verified in the prescribed manner containing all the prescribed particulars. Such return of income must be furnished by the representative assessee within the time prescribed u/s 139(1).

Taxability of total income of the trust [Section 164(2)]

Total Income as computed above shall be assessable as the income of an association of persons. The association of persons is taxable at the same rate as applicable to an individual.

However, if the whole or any part of the relevant income is not exempt u/s 11 or 12 due to the following, it shall be charged at the maximum marginal rate:

- (i) if any part of the income *enures* directly or indirectly for the benefit of any person referred to in section 13(3), or
- (ii) if any part of such income or any property of the trust, which during the previous year is used or applied for any persons referred to in section 13(3), or
- (iii) if funds of the trust are not invested in the mode specified under section 11(5).

Highlights of the Explanatory Notes on the provisions relating to Fringe Benefit Tax

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CBDT has issued Circular No. 8/2005, dated 29-8-2005 giving the Explanatory Notes on the provisions relating to Fringe Benefit Tax. The major highlights of the Explanatory Notes are as under:

1. FBT is payable by a person if he satisfies the following conditions:—
 - (i) He is an employer;
 - (ii) He has employees based in India;
 - (iii) He is a company or a firm or an association of persons or a body of individuals or a local authority or an artificial juridical person;
 - (iv) His income is not exempt under section 10(23C) of the Income-tax Act or he is not registered under section 12AA;
 - (v) He has provided the following fringe benefits:—
 - (a) contributes to an approved superannuation fund for employees;
 - (b) provides free or concessional tickets for private journeys of employees or their family members;
 - (vi) He has, during the course of his business or profession (including any activity whether or not such activity is carried on with the object of deriving income, profits or gains) incurred any expense on, or made any payment for, the purposes referred to in clauses (A) to (P) of sub-section (2) of section 115WB of the Income-tax Act. These purposes are enumerated in para 3.3 of this circular.
2. An entity, which does not have any employee on its rolls, will not be liable to FBT.
3. FBT is not payable by a trust, fund or institution if its income is exempt under section 10(23C) or it is registered under section 12AA of the Income-tax Act. A company registered under section 25 of the Companies Act will also not be liable to FBT if its income is exempt under section 10(23C) or such company is registered under section 12AA of the Income-tax Act.
4. The provision relating to the computation of the value of the fringe benefits is contained in section 115WC. It is a settled principle of law that where the computation provision fails, the charging section cannot be effectuated. Therefore, if there is no provision for computing the value of any particular fringe benefit, such fringe benefit, even if it may fall

within clause (a) of sub-section (1) of section 115WB, is not liable to FBT.

5. The value of any benefit provided by the employer to its employees by way of allotment of shares, debentures, or warrants directly or indirectly under any Employees Stock Option Plan or Scheme of the company is not liable to FBT.
6. Where a company incurs expenditure on travelling, hotel etc. wholly and exclusively for executing an assignment for its client and the client reimburses the company for such 'out of pocket' expenses, the company is liable to FBT in respect of such expenditure.
7. An Indian company would be liable to the FBT in India if it has employees based in India. Therefore, if an Indian company carries on business outside India but does not have any employees based in India, such company would not be liable to the FBT in India.
8. FBT will apply to foreign companies if it has employees based in India.
9. FBT will apply to liaison offices of foreign companies in India if the liaison offices have employees based in India.
10. Where the employer recovers from its employees, any amount of expenditure incurred for the purposes listed in clauses (A) to (P) of sub-section (2) of section 115WB, the value of the fringe benefits shall be determined with reference to the net expenditure and not gross expenditure. For example, if an employer incurs a total expenditure of Rs. 10 lakhs on repair, running and maintenance of motor-cars, and recovers Rs. 1 lakh from its employees, the value of the fringe benefit in respect of repair, running and maintenance of motor-cars shall be calculated on the basis of the net expenditure of Rs. 9 lakhs (*i.e.*, Rs. 10 lakhs minus Rs. 1 lakh.).
11. Where expenses are disallowed under section 37 on the plea that the expenses are personal or the expenses are identified as bogus, FBT will not be applicable to such expenses which are disallowed.
12. For the purposes of payment of advance tax on fringe benefits, tax depreciation should be taken on a *pro rata* basis for payment of advance FBT.
13. An employer is liable to FBT if it is engaged in business or profession or any activity, whether or not such activity is carried on with the object of deriving income, profits or gains.

14. LTC provided to employees specified under section 17(1) is not subject to FBT while LTC provided to non-specified employees will be subject to FBT.
15. The expenditure on 'brand' or 'brand ambassador' or 'celebrity endorsement' is liable to FBT.
16. Brokerage and selling commission paid for selling goods are in the nature of ordinary selling expenses and therefore FBT is not payable on such expenses.
17. Discounts or rebates or bonus points allowed to customers or wholesale dealers are in the nature of selling expenses and are not liable to FBT.
18. Any expenditure (including expenditure on artwork and royalty charges) on free offers (with products) such as freebies like tattoos, cricket cards or similar products, to trade or consumers (excluding employees) is for the purposes of sales promotion and, publicity and accordingly, liable to FBT.
19. Medical reimbursement is liable to FBT if the reimbursement is below Rs. 15,000. If the reimbursement exceeds Rs. 15,000 FBT is not applicable as the reimbursement is chargeable as salary in the hands of the employee.
20. Prizes or rewards to employees for achievements will be liable to FBT.
21. Where per-diem allowance is paid for the purposes of use of hotel, boarding and lodging facilities, it would fall within the scope of clause (G) of sub-section (2) of section 115WB. However, the employees will not be liable to pay income tax on any surplus accruing to him from such allowance.
22. Rent paid or payable for an operating lease of a motor-car is expenditure for the purposes of conveyance, tour and travel. Accordingly, it shall be treated as expenditure within the scope of clause (F) of sub-section (2) of section 115WB. However, rent paid or payable for a financial lease of a motor-car is in the nature of expenditure on running or maintaining of a motor-car. Therefore, such rent shall be treated as expenditure within the scope of clause (I) of sub-section (2) of section 115WB.
23. Interest on loans taken for purchase of cars falls within the scope of clause (H) of sub-section (2) of section 115WB relating to repair, running and maintenance of motor cars. Accordingly, expenditure by way of interest on loans taken for purchase of cars is liable to FBT.
24. Delivery/display vans, trucks/lorries, ambulance and tractor are not "**motorcars**" within the meaning of clause (H) of sub-section (2) of

section 115WB. Therefore, expenditure on the running, repair and maintenance of such vehicles is not liable to FBT.

25. Expenditure on items like refrigerators, televisions, furniture and similar items in a guesthouse would not fall within the scope of clause (K) of sub-section (2) of section 115WB since the proximate objective of incurring such expenditure is the acquisition of a capital asset. Further, depreciation on these as sets would also not be liable to FBT in the absence of any specific charge.
26. Expenditure on meeting/get-togethers of employees and their family members on the occasion of any festival like 'Navratri', 'Diwali' 'Id', 'Christmas' or 'New Year' is expenditure on festival celebrations. Such expenditure is liable to FBT.

However, expenditure on celebration of Independence Day and Republic Day will not be liable to FBT because they are not 'festivals' as normally understood.

27. FBT is payable on the expenditure incurred or payment for the purposes of scholarship irrespective of whether the recipient is an employee or his relative or any other person.
28. Any excess advance tax paid for the preceding quarter can be adjusted against the advance tax for the subsequent quarter(s).