

THREE	ASSESSMENT OF CHARITABLE TRUSTS AND RELIGIOUS INSTITUTIONS - TAX EXEMPTIONS	52-65
	3.1 Introduction	
	3.2 Essential Conditions for Exemptions	
	3.3 Computation of Trust Income for Assessment purposes.	
	3.4 Absolute Tax Exemptions	
	3.5 Legislative Changes since 1961	
	References	

## CHAPTER THREE

**ASSESSMENT OF CHARITABLE TRUSTS AND RELIGIOUS INSTITUTIONS - TAX EXEMPTIONS**

---

**3.1 Introduction:**

A discussion has been made in the preceding Chapter relating to the statutory provisions contained under the Income-tax Act, alongwith certain specific features which govern these provisions. The statutory provisions relating to the assessment of charitable and religious trusts have undergone frequent changes right from the year 1970 to this date. It appears from these changes that there is a continuous effort to block the various loopholes existing in law.

**3.2 Essential Conditions for Exemptions:**

In order to secure exemption under section 11 of the Income-tax Act, a charitable or religious trust must satisfy the following conditions:

- (1) the property from which income is derived should be held under trust or other legal obligation.<sup>1</sup>
- (2) The property should be held under trust or other legal obligation for charitable or religious purposes for the benefits of the public.<sup>2</sup> Where it is a charitable trust or institution created after 1.4.1962, it should not be created for the benefit of any particular religious community or caste.<sup>3</sup> Even if hedging transactions are carried out by the trustees in order to safeguard against

the loss in the holding of stock and shares in trust, such transactions cannot be termed as speculative transaction within the meaning of section 43(5) and income therefrom would be exempt under section 11(1)(a).<sup>4</sup>

- (3) No part of income of a charitable or religious trust or institution created after 1.4.1962 should enure or be used or applied directly or indirectly, for the benefit of the settlor or other specified persons.<sup>5</sup>
- (4) Exemption is confined to the extent of application of income to charitable or religious purposes in India,<sup>6</sup> or its accumulation for application to such purposes and investment in specified forms.<sup>7</sup> Thus, 100% of income may be exempt if it is applied to such purposes or accumulated for application thereto.<sup>8</sup>
- (5) The trust should get registered with the Commissioner with the time prescribed under section 12A(a).
- (6) The trust should get its accounts audited for the accounting year in which its income exceeds Rs.25,000.<sup>9</sup>
- (7) The income of the trust should not be invested after 28.2.1983 otherwise than in forms specified in section 11(5) or should not remain invested, if so invested before 1.3.1983, otherwise than in specified forms after 30.11.1983 and no shares in a company other than a Government company or statutory corporation should be held after 30.11.1983.

It must, however, be pointed out that the provisions under section 11 do not over-ride the provisions of

section 10. As observed by Acharya Shuklendra in his work "Law of Income Tax" (First Edition, p.643):

*It may be noted that the provisions of section 11 do not override the provisions of section 10. Accordingly, if a trust or institution is entitled to exemption under clauses (21) to (23C) of section 10, exemption would be available to it despite the fact that its case also falls under section 11 and it is not entitled to exemption thereunder. Thus, sub-section (4A) inserted with effect from 1.4.1984 applicable from the assessment year 1984-85 has taken away exemption in respect of business income of a trust or institution except in a limited sphere.<sup>10</sup> But the provisions of clauses (21) to (23C) of section 10 and as such, exemption in respect of business income of a trust or institution, etc., referred to in these clauses, will continue to be exempt from income-tax.<sup>11</sup>*

### **3.3 Computation of Trust Income for Assessment Purposes:**

An attempt is made hereunder to explain the actual assessment and computation of tax liability:

#### Example:

A trust created before 1.4.1962, partly for charitable purposes, has the following income for the assessment year 1990-91:

- i) Income from property held in trust  
for charitable purposes Rs.60,000.00

75% of the income of trust for charitable purposes	Rs 45,000.00
<u>less: Amount actually applied</u>	<u>20,000.00</u>
Balance liable to tax	25,000.00
ii) Income from the remaining part of the trust property (non-charitable purposes) in which the shares of the beneficiaries are not known	<u>20,000.00</u>
<u>Total Income liable to tax</u>	<u>45,000.00</u>

The tax payable will be:

(1) tax on Rs.25,000 relating to charitable part as if it were the total income of an A.O.P.	1,400.00
(2) tax on Rs.20,000 at the maximum marginal rate of tax @54%	<u>10,800.00</u>
<u>Total Tax</u>	<u>12,200.00</u>

After going through the various statutory provisions,  
the following factors emerge therefrom:

- (1) As regards exemption of capital gains, V.G.Mehta, in his "Income-tax Ready Reckoner : Assessment Year 1990-91", points out that:

***Exemption of Capital Gains [Section 11(1A)]:***

*On sale of a capital asset of a charitable trust, whether it is a long-term or a short-term capital asset, and reinvesting the net consideration (i.e. sale proceeds as reduced by any expenditure incurred wholly and exclusively in connection with such sale)*

*in another capital asset, then, the capital gain equivalent to reinvestment in the new asset shall be deemed to have been applied to charitable purposes and will, therefore, be exempt. If any long-term capital gain is chargeable, it will be subject to relief: (a) upto assessment year 1987-88 under section 80T, and (b) for the assessment year 1988-89 and onwards under amended section 48(1)(b).*

- (2) The exemptions under section 11 are not available in certain cases, which has also been pointed out by V.G. Mehta:

*The following income of charitable or religious trust does not qualify for exemption under section 11:*

(1) *Any income of private religious trusts which does not enure or the benefit of public [section 13(1)(a)].*

(2) *Any income of charitable trusts and institutions created or established after 31.3.1962 for the benefit of any particular religious community or caste [section 13(1)(b)].*

(3) *Any income of religious trusts and institutions created or established after 31.3.1962 which enures directly or indirectly for the benefit of any person referred to in sub-section (3) of section 13, i.e. author of the trust or founder of the institution or a substantial contributor to the trust or institution or any relative of such author, founder or substantial contributor, etc. [section 13(1)(c)(i)].*

*The exemption under section 11 will also be denied in cases where any part of the income of the charitable or religious trust is used or applied directly or indirectly for the benefit of any person whose total*

contribution upto the end of the relevant previous year exceeds Rs.25,000 [section 13(3)(b)].

(4) Any income of religious trusts and institutions whether created or established before or after 31.3.1962, if any part of their income or property is, during the previous year, used or applied, directly or indirectly, for the benefit of any person referred to in (3) above. Further, in the case of trusts or institutions created or established before 1.4.1962, the exemption under section 11 will not be denied if any part of their income or property is used or applied or the benefit of any person referred to in (3) above in compliance with the mandatory term of the trust or a mandatory rule governing the institution [provisos to section 13(1)(c)].

(5) In a case where the funds of the trust or institution are invested in a concern in which any person referred to in (3) above, has a substantial interest [(meaning thereby that the) said person shall be deemed to have substantial interest in a concern, being a company, if they beneficially own shares (not being shares entitled to a fixed rate of dividend) carrying not less than 20% of the total voting power and in the case of any other concern, they are entitled, either singly or taken together, to not less than 20% of the profits of such concern. However, if the investment by the trust in such concern does not exceed 5% of the capital of such concern.. However, if the investment by the trust in such concern does not exceed 5% of the capital of such concern, the income of the trust from such concern alone is not entitled to exemption, but the rest of the income of the trust will qualify for exemption], and such investment exceeds 5% of the capital of the concern [section 13(4)].

(6) Any profits and gains of business will not be exempt in the case of charitable or religious trusts and institutions except in cases covered under clause (a) and (b) of section 11(4A) given above under the heading "Business Income of the Trust".

(3) The Act prescribes a uniform pattern of investment, which has also been explained by V.G.Mehta as under:

*Investments of Charitable Trust as laid down in Section 11(5):*

1. *Investment in government savings certificates,*
2. *Investment in immovable property,*
3. *Deposit in any account with Post Office Savings Bank,*
4. *Deposit in any account with:-*
  - (a) *any nationalized bank, or*
  - (b) *State Bank of India or any of its subsidiaries, or*
  - (c) *scheduled bank, or*
  - (d) *co-operative Bank.*
5. *Investment in units of the Unit Trust of India.*
6. *Investment in Central or State Government security.*
7. *Investment in debentures of any company or corporation where the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central or State Government.*
8. *Investment or deposit in any public sector company as defined in section 2(36A).*
9. *Deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is approved by the Central Government u/s. 36(1)(viii).*
10. *Deposit with or investment in any bonds issued by a public company formed and registered in*



in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes and which is approved by the Central Government for the purposes of section 36(I)(viii).

11. Deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964.
12. With effect from 1.4.1989, any other form or mode of investment or deposit as may be prescribed (Refer rule 17C). (Note: Under Income-tax Rule 17C, investment or deposits made in the mutual fund referred to in section 10(23D) provided that the amount of subscription to any units issued by such mutual fund is subscribed wholly in the various forms or modes of investment or deposits specified in (1) to (11) above.) Further, section 13(1)(d) provides that the trust will forfeit the exemption from tax, if:
  - (a) any trust fund is invested after 28.2.1983, otherwise than in any approved pattern of investment as detailed above,
  - (b) any trust fund having invested in non-approved pattern of investment before 1.3.1983 and continues to be so invested after 30.11.1983,
  - (c) the trust holds shares in a company other than a Government company or a statutory corporation after 30.11.1983. However, the above provisions shall not apply in relation to:-
    - i. any assets held by the trust or institution where such assets form part of the corpus of the trust or institution as on the 1st day of June, 1973, and such assets were not purchased by the trust or institution or acquired by it by

*it by conversion of, or in exchange for, any other asset;*

- ii. any assets (being debentures issued by, or on behalf of, any company or corporation) acquired by the trust or institution before the 1st day of March, 1983;*
- iii. any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year commencing on the 1st day of April, 1984, or any subsequent assessment year.*

*Where the trust or institution has any other income in addition to profits and gains of business, the provisions of (iii) above shall not apply unless the trust or institution maintains separate books of accounts in respect of such business.*

#### **3.4 Absolute Tax Exemption:**

Notwithstanding conditions substantive or procedural, the tax policy encourages laudable objects like education and medical relief by granting absolute tax exemption. Thus, under section 10(22), the income of any University or any other educational institution existing solely for educational purposes and not for the purpose of profit is exempt. Similarly, the income of any hospital or any other institution for the reception and treatment of persons existing solely for philanthropic purposes and not for purposes of profit is exempt. Besides the above mentioned trust or institution, any other association engaged in scientific research or an association whose object

is promotion of sports, or an association or body of professional nature like Bar Council, etc., or an institution established as a public charitable trust or registered under the Societies Registration Act existing solely for the development of Khadi and Village Industries are exempt on its income subject to the conditions and extent mentioned in those respective provisions. Further, the funds for various specific purposes in the name of Prime Minister's National Relief Fund, Prime Minister's Fund (Promotion of Folk Art) or Prime Minister's Aid to Students Fund are totally exempt from tax. Moreover, any trust or association may be granted total exemption on its income through a gazettee notification made by the Central Government in this behalf under section 10(23-C) (iv). However, while granting exemption, the objects of the trust and its importance shall be looked into.

One significant aspect of a trust or association claiming exemption under any of the clauses of section 10, as mentioned above, is that sub trusts are not required to comply with any one of the requirements laid down in sections 11 to 13 of the Act.

### **3.5 Legislative Changes since 1961:**

(i) 1970 -- The Finance Act, 1970, brought about the following amendments with effect from 1.4.1971:

- i. Certain words in clauses (a) and (b) of sub-section (1) were omitted;

- ii. the Explanation to sub-section (1) was substituted;
- iii. sub-section (2) was substituted;
- iv. sub-section (3) was substituted;
- v. in sub-section (4), the words, brackets and figures "and accordingly, chargeable to tax within the meaning of sub-section (3)" were omitted.

(ii) 1971 - Sub-section (1A) was inserted by the Finance (No.2) Act, 1971, with retrospective effect from 1.4.1962, providing for the treatment of capital gains derived by charitable and religious trusts. This sub-section has since witnessed no amendment.

(iii) 1972 - The Finance Act, 1972, made a drafting change in clause (c) of sub-section (1) by inserting the word 'derived' after the word 'income' in the beginning so as to harmonize the language of this clause with the language of clauses (a) and (b) of sub-section (1).

(iv) 1975 - The Direct Taxes Enquiry Committee (Wanchoo Committee) had recommended in its Final Report submitted in 1971 that the laws should be suitably amended to provide that where a trust for the relief of the poor, education or medical relief derives income from any activity for profit, its income should be exempt from income tax only if the said activity for profit was carried on in the course of the actual carrying out of a primary purpose of the institution. The Committee went on to say that even where a business is settled in trust, the trust should fulfil this condition if it is to enjoy tax exemption in respect of income derived from such business.

In making this recommendation, the Committee had apparently assumed, on the basis of the case law available till then, that in respect of the fourth head, viz "Any other object of general public utility", the addition of the crucial ten words in the definition in the 1961 Act had served the purpose that was in view both in respect of businesses held in trust as well as those carried on on behalf of the trust, an assumption which, as would be seen presently, did not hold good. The recommendation of the Committee was translated into action by inserting through the Taxation Laws (Amendment) Act, 1975, a new clause 13(i)(bb) in section 13 of the Income Tax Act, 1961, denying the exemption to the business incomes of charitable trusts or institutions for, relief of the poor, education or medical relief unless "the business is carried on in the course of the actual carrying out of a primary purpose of the trust or institution".

(v) 1977 - The Finance (No.2) Act, 1977, substituted sub-clause (ii) of Clause (b) of sub-section (2) with effect from 1.4.1978 and also inserted an Explanation from the same date in sub-clause (iii) of clause (b) of sub-section (2).

(vi) 1983 - The Finance Act, 1983, has made two important changes in the law. Firstly, section 3(a) of that Act has deleted the words "not involving the carrying on of any activity for profit" added in 1961 to the definition of 'charitable purpose' in section 2(15) of the Income-tax Act, 1961. Secondly, sections 6 and 7 of that Act have deleted the provision in section 13(1)(bb) of the Income-tax Act, 1961, made at the

instance of the Wanchoo Committee in 1975, and, instead, inserted the following new sub-section (4A) in section 11:

(4A) Sub-section (1) or sub-section (2) or sub-section (3) or sub-section (3A) shall not apply in relation to any income, being profits and gains of business, unless

(a) .....

(b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution and separate books of accounts are maintained by the trust or institution in respect of such business.

Some of the implications of these new provisions may be examined in the context of the historical evolution.

(vii) 1984 - The Finance Act, 1984, inserted clause (xi) in sub-section (5) with effect from 1.4.1985, applicable from assessment year 1985-86, so as to include the deposits with the Industrial Development Bank of India, as one of the modes of investing or depositing money accumulated or set apart by the charitable or religious trusts.

(viii) 1987 - The Direct Tax Laws (Amendment) Act, 1987, has omitted section 11 with effect from 1.4.1989. However, a separate section 80F has been inserted by the same amending Act with effect from the same date to deal with the exemption of income of public charitable and religious trusts.

REFERENCES

1. See section 13, Explanation 1
2. See section 2(15) and 13(1)(A)
3. Section 13(1)(b)
4. Addl.CIT v. Rajasthan Charity Trust (1986) 56 CTR (Raj);  
248; (1987) 165 (ITR) 759 (Raj.)
5. Section 13(1)(c), (2) and (3)
6. Section 11(1)(a) and (b)
7. Section 11(2) and (5)
8. See CIT v. Estate of B.P.Kaya Trust (1985) 155 ITR 60  
(Cal.); (1985) 47 CTR (Cal.) 366.
9. Section 12A(b)
10. See paragraph 11(ii)(a).
11. See Board's Circular No.372, dated 8.12.1973