

Taxability of Charitable & Religious Trusts

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1. 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.

1a 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.

1b 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.

1c 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*. Public-cum-private created on or after 1-4-1963 shall not be eligible for

exemption u/s 11,.

2. Creation of a Trust

(A) Creation of a private trust: A Private Trust may be created *inter vivos* or by will. If a trust is created by will it shall be subject to the provisions of Indian Succession Act, 1925.

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.

(B) 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 (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.

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 derived from a property held under 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 account are maintained by such trust/institutions in respect of such business.

3. 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".

A charitable organisation is ordinarily formed by way of a trust or a company limited by guarantee under section 25 of the Companies Act, 1956 or a society under the Societies Registration Act, 1860 (Central) or under a State Act in case there is one. As far as the tax angle is concerned, it makes no difference whether the charitable organisation is formed by way of trust, a company or a society.

A trust can be oral but for recognition as a charitable institution, it should be in writing and should have three certainties:

- (1) certainty as regards property which is the object of the trust;
- (2) the object themselves; and
- (3) the beneficiaries for whom they are intended.

A Wakf under Mohammedan law is created under the Wakf Act, 1995 (previously under the Muslim Wakf Act, 1923). The difference between trust law and wakf is that the latter is created either by a Muslim or by a competent court by dedication of immovable property to God for religious, pious or charitable purposes. Such wakfs are managed by Mutawali whose powers are at par with that of trustee.

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.

The exemption outlined in section 11 are subject to the fulfillment, not only of the various conditions set out in this section but also those set out in sections 12, 12A, 12AA, 13 and 60 to 63.

3a Conditions to be satisfied for claiming 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;

Amendment made by the Finance Act, 2008

With a view to limiting the scope of the phrase "*advancement of any other object of general public utility*", the Act has

amended section 2(15) so as to provide that "the advancement of any other object of general public utility" shall not be a charitable purpose if it involves the carrying on of—

- (a) any activity in the nature of trade, commerce or business or,
- (b) any activity of rendering of any service in relation to any trade, commerce or business,

for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

The purpose of bringing this amendment was that number of entities operating on commercial lines are claiming exemption on their income either under section 10(23C) or section 11 of the Act on the ground that they are charitable institutions. This is based on the argument that they are engaged in the "advancement of an object of general public utility" as is included in the fourth limb of the current definition of "charitable purpose". Such a claim, when made in respect of an activity carried out on commercial lines, is contrary to the intention of the provision.

The entities effected due to the above amendment are housing boards, chamber of commerce, port trust, etc. as the Supreme Court in case *CIT v Gujarat Maritime Board* (2007) 295 ITR 561 (SC) held that the assessee who is engaged in developing and maintaining minor ports in State of Gujarat is carrying on a 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 the maximum amount which is not chargeable to tax* 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.
- (e) The trust must get itself registered with the Commissioner of Income-tax within the prescribed time.
- (f) Where the "property held under a trust" includes a business undertaking, the provisions of sections 11(4) shall be applicable. On the other hand, if the trust wishes to carry on business, the profits or gains earned from such business shall not be exempt under section 11, unless the business is incidental to the attainment of the objectives of the trust/institution and separate books of account are maintained by such trust and institution in respect of such business.
- (g) 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 religious 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.

- (h) The funds of the trust should be invested or deposited in the permissible forms and modes prescribed in section 11(5).

4. 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 conditions mentioned under para 3a above are satisfied:

(a) ***Income from property held under trust wholly for charitable or religious purposes [Section 11(1)(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 purposes; 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;

(b) Income from property held under trust which is applied in part only for charitable or religious purposes [Section 11(1)(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.

(c) Income from property held under trust which is applied for charitable purposes outside India [Section 11(1)(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(1)(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% of the income should be applied during the previous year in which it is earned is not applicable in this case.

It is not sufficient that the property is indirectly responsible for the income; it is necessary that the income must directly and substantially arise from the property held under trust. The property must be the effective source from which the income arises. **[J.K. Trust (Bom)].**

- (1) Although corpus donations are fully exempt but these are to be considered for the limit of maximum amount which is not chargeable to income tax *i.e.* Rs. 1,00,000 prescribed for audit of accounts of the trust. Further, such donations are also required to be invested only in the mode specified in section 11(5).
- (2) *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 at least 85% of income) and the provision of section 13 shall apply accordingly. Thus as per *Explanation 1* to section 11 in computing the 15% 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.*
- (3) 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.

- (4) "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. [*See* para 7]
- (5) University and other educational institutions as well as hospitals or other medical institutions can claim exemption under section 10(23C) instead of section 11. [*See* 14].

Summarised Table of Exempt income in case of Charitable or Religious Trust

<i>Sl. No. Nature of income</i>	<i>To what extent exemption allowed</i>	<i>Conditions applicable</i>	<i>Relevant provisions</i>	<i>Remarks if any</i>
(a) Income derived from property held under trust wholly for charitable or religious purposes	To the extent such income is applied in India for such purposes	Accumulation allowed upto 15% of such income Accumulation in excess of 15% allowed subject to certain conditions being satisfied	Section 11(1)(a) Section 11(2) (See para 5)	Accumulation treated as applied for such purposes—do—
(b) Income derived from property held under trust which is applied <i>in part</i> only for charitable or religious purposes	—do—	(i) —do— (ii) Trust should have been created before 1-4-1962	Section 11(1)(b)	—do—
(c) Income derived from property held under trust— (i) Created on or after 1-4-1952 for charitable purposes to be used for charitable purposes outside India (Religious trust not covered)	To the extent such income is applied to such purposes outside India	The purpose of the trust is to promote international welfare in which India is interested. Further General or special order of Board for exemption is necessary No accumulation allowed	Section 11(1)(c)(i)	Accumulation not exempt
(ii) Created before 1-4-1952 for <i>charitable or religious purpose</i> to be used for such purposes outside India	To the extent such income is applied outside India for such purposes	No condition applicable but General or special order of Board for exemption is necessary	Section 11(1)(c)(ii)	Accumulation not exempt
(d) Voluntary contribution forming part of corpus	100% exempt with no condition of application or accumulation	There should be specific direction that such contribution to from part of corpus of the trust or institution	Section 11(1)(d)	

Any voluntary contribution received by a trust institution created *wholly for charitable or religious purposes* (not being contribution made with a specific direction that they shall form part of corpus) shall for the purpose of section 11 be deemed to be income derived from property held under trust wholly for charitable or religious purposes [Section 12]

4a 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 at least 85%* of such income during the previous year for charitable or religious purposes. He can accumulate upto 15% of such income to be utilized for charitable or 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. [Refer para 5]

4b 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 [Clause 2 of the Explanation 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 reason that whole or part of 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 2006-07 is received on 15-4-2007, *i.e.*, next year, such income should be applied for charitable or religious purposes either during previous year 2007-08 and/or 2008-09.
- (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 28-1-2007 and it could not be spent in the previous year 2006-07 for any reason, it could be applied in the next previous year *i.e.* 2007-08.

To avail the facility of the above extended period of application of income, the *trust has to exercise an option in writing* before the due date of filing return under section 139(1).

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.

Example for reason (a)

During the previous year 2006-07 a charitable trust earned an income of Rs. 5,00,000 out of which Rs. 4,00,000 was received during the previous year 2006-07 and the balance Rs. 1,00,000 was received during the previous year 2007-08. To claim full exemption of Rs. 5,00,000 in the previous year 2006-07, 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 2006-07.
- (iii) How much amount will be deemed to be utilized during the previous year 2006-07 and within what time should it be actually utilized.

Answer

	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 2007-08 should be actually utilized either during the previous year 2007-08 or previous year 2008-09	

Ans. (i) Rs. 75,000; (ii) Rs. 3,25,000; (iii) Rs. 1,00,000 to be actually utilised till 31-3-2009.

Example for reason (b)

During the previous year 2006-07 a charitable trust earned an income of Rs. 5,00,000. Out of this an income of Rs. 1,00,000 was received on 29-3-2007. Although the amount of Rs. 1,00,000 has been received during the previous year 2006-07 itself, but it may not be possible to spent such amount within the previous year as it has been received on 29-3-2007. Therefore, it has been provided, that such sum can be applied at any time during the immediately following previous year *i.e.*, upto 31-3-2008. If the amount is so utilized during the immediately following previous year, it shall be deemed to have been utilized in the previous year 2007-08 itself.

Consequences if the income is not actually applied within the prescribed period after exercising the above 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 31-3-2009 it will be treated as the income of previous year 2008-09.

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 31-3-2008 it will be treated as income of previous year 2007-08.

4c Mode of computation of income of a trust: Where the trust derives income from house property, interest on securities, capital gains, or other sources, the word 'income' should be understood in its commercial sense, *i.e.*, book income, after adding back any appropriations or applications thereof towards the purposes of the trusts or otherwise, and also after adding back any debits made for capital expenditure incurred for the purposes of the trust or otherwise. It should be noted, in this connection, that the amounts so added back will become chargeable to tax under section 11(3) to the extent that they represent outgoings for purposes other than those of the trust. The amounts spent or applied for the purposes of the trust from out of the income computed in the aforesaid manner should be not less than 75% (now 85%) of the later, if the trust is to get the full benefit of the exemption under section 11(1). [Circular No. 5P (XX-6), dated 19-6-1968].

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 income is arrived at after meeting the required expenses and charges including the expenses of maintaining the trust property, salaries and miscellaneous expenses, legal expenses connected with the affairs of the trust, depreciation, payment of income-tax and other taxes but excluding loss on sale of investment or apportioning any part of such expenses to capital donations received by the trust. 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. [**Sheth Manilal Ranchhoddas Vishram Bhavan Trust (Guj)**. See also **Bhoruka Public Welfare Trust (Cal)**].

Depreciation is also application of income: (a) Depreciation shall be allowed on the assets, the cost of which had been fully allowed as application of income under section 11. Depreciation is even allowable on assets received on transfer when the assessee had not incurred the cost of acquiring the assets, even though it has already treated as application of income in the hands of the transferor trust. [**Institute of Banking Personnel Selection (IBPS) (Bom)**].

4d Meaning of "Applied": Applied, in this context, means that the income is actually applied for the charitable or religious purposes of the trust. The word applied need not necessarily imply spent. Even if an amount is irretrievably earmarked and allocated for the charitable or religious purpose(s), it may be deemed to have been applied for its purposes. A mere credit entry in the books of the trust in the expectation of future income is not sufficient but a credit entry made to allocate already earned income followed by some payments made in the year was held proper application. [**Thanthi Trust (Mad)**].

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. [(**1988**) **170 ITR 62 (Ker)**].

Repayment of a debt incurred for charitable purposes by a charitable trust and loans advanced by educational trusts are application of income:: Repayment of loan taken for construction of a building by the assessee for the purpose of augmenting its funds shall qualify as income applied for charitable purpose. [**Janmabhoomi Press Trust (Kar)**].

Excess application in an earlier year may be set off against next year's income: Where a trust or institution expends or applied more than its income, it can only mean that such excess amount is from corpus or future income. The intention whether it from corpus or future income should be manifest from the accounts. If such deficit is debited to corpus, it should ordinarily mean that the corpus is used or applied for the purpose of the trust so that there can be no objection to such use. On the other hand, if the deficit is merely carried forward, it would be clear, that the intention is to absorb such deficit against future income.

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. [**Maharana of Mewar Charitable Foundation (Raj)**].

Excess expenditure of an earlier year can be adjusted against income of subsequent year and such adjustment is to be treated as application of income in subsequent year. [**Shri Plot Swetamber Murti Pujak Jain Mandal (Guj)**].

5. Accumulation of income in excess of 15% 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 deemed to have been applied for charitable or religious purposes in India during the previous year itself.

Section 11(2) further liberalises and enlarges the exemption given under section 11(1)(a). A combined reading of both the provisions would clearly show that section 11(2), while enlarging the scope of exemption, removes the restriction imposed by section 11(1)(a) but it does not take away any the exemption allowed by section 11(1)(a). **[G.R. Govindarajulu & Sons Charities (Mad)].**

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 in any case.

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

1. In computing the period of 5 years, 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.
2. 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]

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).
- (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: The *Explanation* under section 11(2) provides that any amount credited or paid out of the income *referred to in section 11(1)(a) or (b) read with explanation* to that sub-section 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.

5a Consequences if such accumulated income in excess of 15% 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 ceases to be accumulated or set apart for application thereto, or
- (b) ceases to remain invested or deposited in any mode mentioned under section 11(5) above, or
- (c) 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.
- (d) 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 for other purpose or ceases to be accumulated or set apart, or

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

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

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

However, in computing the aforesaid period of 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.

5b Circumstances where the accumulated income in excess of 15% 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 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. On such an application being allowed by the Assessing Officer, the funds may be accumulated and/or applied for the purposes newly specified and the provisions regarding withdrawal of exemption will be applicable on the basis that new purposes were the ones that had been specified in the notice for accumulation given under section 11(2). 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, but the Assessing Officer may allow application of such accumulated income for the purpose of donation to other trust or institution in the year in which such trust or institution was dissolved.

6. 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.

Treatment of corpus donations: Corpus donations cannot be treated as income in view of the exception under section 12, so that such corpus donations need not be applied for the objects as required for other donations. It is sufficient, if the income therefrom is applied. It is not unusual for trusts to receive such donations for specified purposes not available for application at the discretion of the trustees according to the objects of the trust, so that the main trust need not lose its right to exemption either for non-application or even for the reason that the specific object of such tied-up donation does not fall within the ambit of the objects of the trust. **[Sthanakvasi Vardhman Vanik Jain Sangh (Guj)].**

- (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) **Taxation of certain anonymous donations [Section 115BBC] [W.e.f. assessment year 2007-08]:** In order to tax unaccounted money being contributed to charitable institutions by way of anonymous donations, a new section 115BBC has been inserted so as to provide that any income by way of anonymous donations of the following entities shall be included in the total income and taxed at the rate of 30%.

- (i) any trust or institution referred to in section 11;
- (ii) any university or other educational institution referred to in section 10(23C)(iiiad) and (vi) i.e. its annual receipts is less than or more than Rs. 1 crore;
- (iii) any hospital or other institution referred to in section 10(23C) (iii ae) and (via) i.e. its annual receipts is less than or more than Rs. 1 crore;
- (iv) any fund or institution referred to in section 10(23C)(iv);
- (v) any trust or institution referred to in section 10(23C)(v).

Anonymous donations not covered under section 115BBC

The following anonymous donations shall, however, be not be covered under section 115BBC:

- (a) donations received by any trust or institution created or established *wholly for religious purposes*.
- (b) donations received by any trust or institution created or established for *both religious as well as charitable purposes other than* any anonymous donation made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution.

Anonymous donation means any voluntary contribution referred to in sub-clause (iia) of Clause (24) of section 2, where a person receiving such contribution does not maintain a record consisting of the identity of the person making such contribution indicating the name and address of the person and such other particulars as may be prescribed.

(3) Exemption under section 11(1) not to be allowed in the following case [Section 12(2)]: 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).

(4) 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% of the income from such capital gain for charitable purposes during the previous subject to exception given under section 11(2).

Cases where income from capital gain shall be deemed to have been applied for charitable purposes [Section 11(1A)]: (A) *Transfer of capital asset held under trust wholly for charitable or religious purposes* Section 11(1A)(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 given under section 11.

(B) *Transfer of capital asset held under trust in part only for charitable or religious purposes [Section 11(1A)(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%

	Rs.
Case (a)	
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.

(4) Treatment of donation in kind: Certain funds, trusts and institutions running hospitals, creches orphanages, school, etc., often receive donation in kind from various sources for application towards their charitable purposes. These contributions may be in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipments, etc.

Since the donation in kind, of a nature referred to above, received by a fund, trust or institution would be income within the meaning of section 2(24) of the Act, it is clarified that the use of these towards object for which the fund, trust or institutions is established would be regarded as application of the income of the fund, trust or institution. [Circular No. 580, dated 14-9-1990].

Where a trust received donation in kind and the same could not be used towards objects for which the trust, fund, etc. is established, it should convert the asset in the form or mode specified in section 11(5) before the expiry of one year from the end of the previous year in which asset is acquired.

7. Treatment of business income of a trust

Trust can earn the following two types of business income:—

- (a) Profits and gains from a *business undertaking held under a trust* [Section 11(4)].
- (b) Profits and gains from a business provided such business is incidental to the attainment of the objectives of the trust/institution and separate books of account are maintained in respect of such business [Section 11(4A)].

(a) Profits and gains from a business undertaking held under a trust [Section 11(4)]: 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 undertaking 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 account* 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.

(b) Profits and gains from incidental business [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 account 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.

Consequent to substitution of sub-section (4A), w.e.f. assessment year 1992-93, all that is required for business income of a trust or institution to be exempt is that business should be incidental to attainment of objectives of trust or institution. [**Thanthi Trust (SC)**]. Thus, a business whose income is utilised by the trust or the institution for the purpose of achieving the objective of the trust or the institution is, surely, a business which is incidental to the attainment of the objectives of the trust.

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.

8. 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.

8a 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 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.

Documents to be attached alongwith application in Form 10A [Rule 17A]: Application for registration in Form 10A shall be made in duplicate and shall be accompanied by the following documents, namely:—

- (a) (i) where the trust is created, or the institution 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.

For the purpose of registration of a trust under section 12AA, authorities have to ascertain only genuineness of activities of trust and how income derived from trust property is applied for charitable or religious purposes and not nature of activity by which income is derived by trust. [**Sanjeevamma Hanumanthe Gowda Charitable Trust (Kar)**].

8b 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

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

given a reasonable opportunity of being heard.

Order granting or refusing registration should be passed within six months [Section 12AA(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.

Wherever, application is made, the authorities must act within time-frame. Failure on the part of the authority concerned to pass order within the statutorily laid down period of limitation will give rise to a presumption that registration, as applied for by the assessee, has been granted. This the natural and legal consequence of an action on the part of the department not to have acted within the prescribed time-frame. Otherwise, the executives who are supposed to carry on the intentions of the legislature will only be thriving by their over lapses and latches. [**Karnataka Golf Association (Bang)**].

8c Commissioner empowered to cancel registration of charitable and religious trusts under section 12AA [Section 12AA(3)] [W.e.f. 1-10-2004]

If the Commissioner of Income-tax *is satisfied* that the activities of any trust or institution *are not genuine* or are not being carried out in *accordance with the objects of the trust or institution*, he shall, after giving reasonable opportunity of being heard to the concerned trust or institution, pass an order in writing cancelling the registration granted under the said section.

9. 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 enure 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.

A trust or institution created or established for the benefit of Scheduled Castes, backward classes, Scheduled Tribes or women and children shall not be deemed to be a trust or institution created or established for the benefit of a religious community or caste within the meaning of clause (b) of sub-section (1).

- (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.

The above restriction is obviously intended to ensure that, despite the ostensibly charitable objects of such trust or institution, its income is not diverted away to benefit persons who are closely connected with the creation, establishment and conduct of the trust or institution.

Charitable Trusts not to lose exemption if educational or medical facilities provided to specified persons [Section 13(6)]: A trust running an educational institution or a medical institution or a hospital shall not lose the benefit of exemption of any income under section 11 other than the value of benefits of educational or medical facilities provided to the specified persons referred to in section 13(3), solely on

the ground that such benefits have been provided to such 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) mentioned in para 9a below.

- (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 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.

Anonymous donations to form part of income of trust [Section 13(7)] [W.e.f. assessment 2007-08]: As per the new section 115BBC, anonymous donation shall now be taxable at the maximum marginal rate of 30%. Consequently, a new sub-section (7) has been inserted in section 13 to provide that nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donation referred to in the new section 115BBC on which tax is payable in accordance with the provisions of that section. In other words anonymous donation shall not be excluded from the total income of the assessee.

9a 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.

(g) The trust and institution referred in section 13 are not one and the same thing and they are different entities. Clause (cc) (i.e clause (d) mentioned above) of sub-section (3) of section 13 refers to the manager of the institution and not the manager of the trust and where the advance has been given to the manager of the trust and not to the manager of the institution there is no violation of section 13. [**Rai Bahadur Biseswarlal Motilal Halwasiya Trust (Cal)**].

Every signatory to the memorandum of association has to be treated as founder: In the case of a charitable institution formed as a company, every signatory to the memorandum of association has to be treated as founder, so that money lent to such a person without adequate security constitutes a benefit, which would deprive the exemption for the company. [**Charat Ram Foundation (Del)**].

Further, the Supreme Court decided upon who is a founder. It held that the expression 'founder of the institution' used in section 13(3)(a) means that the person concerned should be the originator of the institution, or at least one of the persons responsible for the coming into existence of the institution. Contribution of money is not an inexorable test of a person being a "founder", though it might happen often that the person who originates an institution may often also fund it. [**Bharat Diamond Bourse (SC)**].

9b Meaning of substantial interest [Explanation 3 to section 13]: 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.

9c Meaning of relative [Explanation 1 to section 13]: 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.

9d 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)].

Letting out of trust property to an interested person is violation of section 13(2): Where the trust property is let out to a partnership in which the trustee was a partner for a meagre rent, there is clear violation of the requirements of section 13(2)(b), so that the trust has to lose its exemption. [**Ram Bhawan Dharamshala (Raj)**].

- (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.

10. 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).

11. Taxability of the income of the charitable or religious trust [Section 164(2)]

As already discussed above, the income of the trust includes the following:

- (a) Income which is derived from property held under trust wholly for charitable or religious purpose *i.e.* income from house property, income from business undertaking held under a trust, capital gain on the transfer of any capital asset of the trust or income from other sources.
- (b) Income which is of the nature referred to in section 2(24)(iia) of the Act *i.e.* voluntary contribution with or without a specific direction that it shall form part of the corpus of the trust.
- (c) Income which is of the nature referred to in section 11(4A) *i.e.* income from an incidental business.

Such income of the trust which is not exempt under section 11 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 of the charitable trust created or established after 1-4-1962 *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).

Section 13(1)(d) states that where the funds of the charitable or religious trust are not invested in a mode given under section 11(5), the exemption under section shall not be allowed and the entire income of the trust

shall be taxable. Further, proviso to section 164(2) states that where the whole or any part of the relevant income is not exempt under section 11 or section 12 by virtue of the provisions contained in clause (c) or clause (d) of sub-section (1) of section 13, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

12. Private discretionary trusts

Income derived from property under a private discretionary trust is chargeable to tax as under:

12a Where shares of beneficiaries are determinate [Section 161]

(1) Where trust income does not include business income [Section 161(I)]: Where there are more than one beneficiary of a private trust and the share falling to each of the beneficiary are determinate, the assessments are to be made on the trustee(s) as a representative assessee under section 161. Such assessment will have to be made at the rate applicable to the total income of each beneficiary. Accordingly, separate assessment for each of the beneficiary on whose behalf the income is received by the trustee will have to made. However as per section 166 the Income-tax department has an option to make direct assessment in the hands of each beneficiary entitled to the income.

The general principle is to charge all income only once. The Assessing Officer should keep this point in view at the time raising the initial assessment either of the trust or the beneficiary and adopt a course beneficial to the Revenue. Having exercised his option once it will not be open to the Assessing Officer to assess the same income for that assessment year in the hands of the other person. [Circular No. 157, dated 26-12-1974].

(2) Where trust income includes business income also [Section 161(IA)]: Where the income of the beneficiary in the hands of trustee being representative assessee consists of or includes profits and gains of business, tax shall be charged on the whole of the income in respect of which such person is so liable at the maximum marginal rate.

However the maximum marginal rate in the above case shall not be chargeable if such profits and gains are receivable under a trust declared by any person by will exclusive for the benefit of any relative dependent on him for support and maintenance and such trust is the *only trust* so declared by him.

12b Where shares of the beneficiaries are indeterminate or unknown [Section 164]

(1) Where the income of such trust does not include business income: In the case of a private discretionary trust, declared by a duly executed instrument in writing where the shares of the beneficiaries are unknown, trustee(s) is liable to tax as a representative assessee at the maximum marginal rate.

But the maximum marginal rate of income tax will not apply in the following cases:

- (i) Where none of the beneficiaries:
 - (a) has taxable income exceeding the exemption limit as applicable to an association of person, or
 - (b) is a beneficiary under any other private trust; or
- (ii) Where the relevant income or part of the relevant income is receivable under a trust declared by any person by will and such trust is the *only trust* so declared by him; or
- (iii) Where the trust, yielding the relevant income or part thereof was created by a non-testamentary instrument before 1-3-1970 and the Assessing Officer is satisfied that it was created *bona fide* exclusively for the benefit of the relatives of the settlor, or where the settlor is a Hindu undivided family, exclusively for the benefit of members of such family in circumstances where such relatives or members were mainly dependant on the settlor for their support and maintenance; or
- (iv) Where the relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created *bona fide* by a person carrying on a business or profession exclusively for the benefit of his employees.

If the case falls within any of the above four exceptions, the relevant income or part thereof is to be taxed at the rate applicable to an association of persons.

Judicial decision

Where the share of beneficiaries was not known, but the trust passed a resolution whereby it decided to disburse the income of the relevant assessment year to one of its beneficiaries and gave the income to such beneficiary, it was held that a mere resolution cannot convert the nature of trust from discretionary to specific. Hence, trust shall be liable to pay tax on its income as a discretionary trust instead of the beneficiary. [**Ambalal Sarabhai D. Trust (Guj)**]

(2) *Where the income of such trust includes business income also*: Where income of such trust consists of, or includes profits and gains of business, the entire income of the trust would be charged at the maximum marginal rate of tax.

However, in a case where the profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance and such trust is the only trust declared by him, the income of the discretionary trust would be charged to tax at normal rates applicable to an association of persons.

13 Oral Trust [*Explanation 2 to section 160*]

An oral trust means a trust which is not declared by a duly executed instrument in writing [including any wakf deed which is valid under the Mussalman Wakf Validating Act, 1913] and which is not deemed under *Explanation 1* to be a trust declared by a duly executed instrument in writing.

As per *Explanation 1* an oral trust will however, be regarded as a trust declared by a duly executed instrument in writing if a statement in writing signed by the trustees, setting out the purposes of the trust, particulars as to the trustees, the beneficiaries and the trust property, is forwarded to the Assessing Officer within the *specified time limit*.

Where the trust has been declared before 1-6-1981, the specified time limit is the period of three months from that day and in any other case, three months from the date of declaration of the trust.

The trustee(s) of such a trust is assessable on such income as representative assessee [Section 160(v)].

13a Charge of income-tax in case of oral trust [Section 164A]: Where a trustee receives or is entitled to receive any income on behalf or for the benefit of any person under an oral trust, then, notwithstanding anything contained in any other provision of this Act, tax shall be charged on such income at the maximum marginal rate.

14. Income of certain funds of national importance, educational institutions and medical institutions [Section 10(23C) and Rule 2C and 2CA]

Any income received by any person on behalf of the following is exempt from tax:

- (a) The Prime Minister's National Relief Fund; or
- (b) The Prime Minister's Fund (Promotion of Folk Art); or
- (c) The Prime Minister's Aid to Students Fund; or
- (d) The National Foundation for Communal Harmony; or
- (e) Any university or other educational institution existing solely for educational purposes and not for purpose of profit and which is wholly or substantially finance by the Government [Sub-clause (iiiab)]; or
- (f) Any hospital or other institution for the reception and treatment of persons (i) suffering from illness or (ii) mental defectiveness or (iii) during convalescence or (iv) requiring medical attention or rehabilitation, existing solely for philanthropic purpose and not for purpose of profit and which is wholly or substantially financed by the Government [Sub-clause (iiiac)]; or
- (g) Any university or other education institution existing, solely for educational purposes and not for purpose of profit if the aggregate annual receipts of such university or education institution do not exceed Rs. 1,00,00,000 [Sub-clause (iiiad)]; or

- (h) Any hospital or other medical institution for the purpose mentioned in clause (f) above where aggregate annual receipts do not exceed Rs. 1,00,00,000 [Sub-clause (iii^{ae})]; or
- (i) Any other fund or institution established for charitable purposes which may be notified by the Central Government in Official Gazette having regards to its object and its importance throughout India or throughout any State or States [Sub-clause (iv)]; or
- (j) Any trust (including any other legal obligation) or institution wholly for public religious purposes or wholly for public religious and charitable purposes which may be notified by the Central Government in the Official Gazette [Sub-clause (v)]; or
- (k) Any university or other educational institution existing solely for educational purposes and not for purpose of profit other than those mentioned in clause (e) and (g) above *i.e.* whose aggregate annual gross receipts exceed Rs. 1,00,00,000 [Sub-clause (vi)]; or
- (l) Any hospital or other institution for the purpose mentioned in clause (f) above but other than those mentioned in clause (f) and (h) above *i.e.* whose aggregate annual receipts exceed Rs. 1,00,00,000 [Sub-clause (via)]

14a Conditions for claiming exemption

	<i>University or educational institution or hospital or medical institution who are substantially financed by the Government [Section 10(23C)(iiiab) and (iiiac)]</i>	<i>University or educational institution or hospital or medical institution whose aggregate annual gross receipts do not exceed Rs. 1 crore [Section 10(23C)(iiiad) & (iii^{ae})]</i>	<i>University or educational institution or hospital or medical institution whose aggregate annual gross receipts exceed Rs. 1 crore [Section 10(23C)(vi) or (via)]</i>	<i>Notified charitable or religious institution covered under section 10(23C)(iv) or (v)]</i>
1. Whether application for grant for exemption necessary	No	No	Yes, approval is necessary	Yes, Notification for exemption is required
2. Form in which application is to be made and to whom it should be made	NA	NA	Form No. 56D to the jurisdictional Chief Commissioner of Income Tax or Director General of Income Tax	Form No. 56 to the Director General of Income Tax (Exemption)
3. Time period within which application is to be made	NA	NA	If application is made on or after 1-6-2006, it shall have to be filed at any time during the financial year immediately preceding the assessment year from which such exemption is sought.	If application is made on or after 1-6-2006, it shall have to be filed at any time during the financial year immediately preceding the assessment year from which such exemption is

			Such application cannot be made for any earlier period	sought. Such application cannot be made for any earlier period
4. Period of the validity of exemption	NA	NA	If application has been made on or after 13-7-2006, it is a permanent exemption unless withdrawn. However, if application has been made before 13-7-2006, the exemption will be for a period of three years and fresh application shall have to be made after the expiry of un-expired period of 3 years which shall also be permanent exemption unless withdrawn	If application has been made on or after 13-7-2006, it is a permanent exemption unless withdrawn. However, if application has been made before 13-7-2006, the exemption will be for a period of three years and fresh application shall have to be made after the expiry of un-expired period of 3 years which shall also be permanent exemption unless withdrawn
5. Time period within which exemption has to be granted or rejected	NA	NA	If application is made on or after 13-7-2006, its approval is to be granted or rejected within a period of 12 months from the end of the month in which application was received by the authorities	If application is made on or after 13-7-2006, its notification will have to be issued or application will have to be rejected within a period of 12 months from the end of the month in which application was received by the Director General (Exemption)
6. Whether Audit of Accounts is compulsory	No	No	Yes	Yes
7. Whether it is mandatory to file return of income	No	Yes	Yes	Yes

14b Other conditions for claiming exemption: The fund, trust or institution covered under section 10(20C)(iv), (v), (vi) and (via) should satisfy the following additional conditions to claim exemption under this section:

- (1) At the time of making application in Form No. 56 or 56D, it should furnish such documents (including audited annual accounts) or information which the Central Government or the prescribed authority as the case may be, may consider necessary in order to satisfy itself about the genuineness of the activities of the fund or trust or institution/university/hospital, etc. and the Central Government or the prescribed authority, as the case may be, may also make such enquiries as it deems necessary in this behalf.
- (2) (a) it should apply its income, or accumulate it for application, wholly and exclusively to the objects for which it is established and in a case where more than 15% of its income is accumulated, the period of the accumulation of the amount exceeding 15% of its income shall in no case exceed 5 years; and
- (b) it should not invest or deposit its funds for any period during the previous year otherwise than in any one or more of forms or mode specified in section: 11(5).

However the following are the exceptions to the above requirement of funds to be invested as per provisions of section 11(5).

- (i) where assets held form part of the corpus of the fund, trust or institution or any university or other educational institution or any hospital or other medical institution as on 1-6-1973;
- (ii) where asset, being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution which form part of its corpus as on 1-6-1998.
- (iii) where assets (being debentures issued by, or on behalf of, any company or corporation), were acquired by the fund, trust of institution or any university or other medical institution before 1-3-1983;
- (iv) where there is any accretion to the shares, forming part of the corpus mentioned in sub-clause (i) and (ii) above, by way of bonus shares allotted it;
- (v) where voluntary contributions are received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the official gazette, specify;
- (vi) where voluntary contribution is received in kind, it has not been held in a mode other than 11(5) after the expiry of one year from the end of the previous year in which such asset is acquired.

1. The grant of exemption from income tax will not apply to any income in the nature of profits and gains of business unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business.
2. Certain funds, trusts and institutions running hospitals, creches orphanages, school, etc., often receive donation in kind from various sources for application towards their charitable purposes. These contributions may be in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipments, etc.

Since the donation in kind, of a nature referred to above, received by a fund, trust or institution would be income within the meaning of section 2(24) of the Act, it is clarified that the use of these towards object for which the fund, trust or institutions is established would be regarded as application of the income of the fund, trust or institution. [Circular No. 580, dated 14-9-1990].

14c Donation to other trust/institutions, etc. out of accumulated income shall not be treated as application of income: Where the above fund or trust or institutions (*i.e.* covered under section 10(23C)(iv), (v), (vi) and (via) do not apply its income during the year of receipt and accumulates it, any payment or credit out of such accumulation to any trust or institution registered under section 12AA or to similar type of fund or

trust or institution or any university or other educational institution shall not be treated as application of income to the objects for which it was established.

14d Anonymous donation shall be included in the total income of trust/ institution covered u/s 10(23C) (iiia), (iiiae), (iv), (v), (vi) and (via) [13th proviso to section 10(23C)] [W.e.f. assessment year 2007-08]: As anonymous donation received by the above trust/institution shall now be taxable under section 115BBC. A proviso has been inserted to section 10(23C) to provide that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income. [See also amendments relating to taxability of anonymous donation under para 6(2)]

14e Withdrawal of approval: Where such fund or institution had been notified or approved by the Central Government or the prescribed authority, as the case may be, and subsequently that Government or the prescribed authority is satisfied that—

- (i) such fund or institution or trust or any university or other educational institution or any hospital or other medical institution has not,—
 - (A) applied its income in accordance with the provisions contained in condition 2(a) mentioned under para 14b above; or
 - (B) invested or deposited its funds in accordance with the provisions contained in condition 2(b) mentioned under para 14b above; or
- (ii) the activities of such fund or trust or institution or any university or other educational institution or any hospital or other medical institution,—
 - (A) are not genuine; or
 - (B) are not being carried out in accordance with all or any of the conditions subject to which such association was notified or approved,

it may, at any time after giving a reasonable opportunity of showing cause against the proposed action to the concerned fund or institution or trust or any university or other educational institution or any hospital or other medical institution, rescind the notification or, by order, withdraw the approval, as the case may be, and forward a copy of the order rescinding the notification or withdrawing the approval to such fund or institution or trust or any university or other educational institution or any hospital or other medical institution and to the Assessing Officer.