



A BRIEF ABOUT PROPOSALS FOR CHARITABLE TRUSTS AND INSTITUTIONS – UNION BUDGET 2021

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Charity is a human instinct that drives man to think favourably of others and do them good. In our country the benevolent role played by charitable and religious trusts has historical background and their existence has originated from the basic cultural traits peculiar to us.

The Direct Taxes Enquiry Committee, in its final report published in December, 1971, had observed that "by tradition, private philanthropy in our country has been playing a very special and prominent role in enriching our cultural heritage and in catering to the education, medical, socio-economic and religious needs of our people. In so doing, it has supplemented the work of a Welfare State, and the State, in turn has recognized its contribution by giving generous tax treatment to the donations to Micro, Small and medium philanthropic institutions and also to the income thereof applied for public, religious or charitable purposes."

The law of taxation of charitable trusts and institutions is highly complex and has always been the subject matter of frequent amendments due to the fact that the medium of charitable institutions is widely perceived as a handy tool for tax planning. Recently the law relating to taxation of educational institutions and hospitals has undergone drastic changes and the Government is keen to bring all the charitable institutions claiming exemption of their income under the Income-tax Act into tighter scrutiny in the coming years.

Due to their distinct organisation and objective entire income of such charitable or religious trusts are taxed as per the provisions of section 11-13 of the Income Tax Act, 1961, which provides for various tax benefits to them.

Proposals in Union Budget 2021.

There are plethora of amendments regarding the provisions for charitable trusts in recent budgets and this year's is also not an exemption to this. The cardinal error of our times is to mistake amendment for improvement and change for progress. The extract of Finance Bill 2021 regarding the proposed changes for charitable trusts are as follows:

In section 11 of the Income-tax Act, with effect from the 1st day of April, 2022,--

(a) in sub-section (1),--

(i) in clause (d), for the word "institution", the words, brackets and figures "institution, subject to the condition that such voluntary contributions are invested or deposited in one or more of the forms or modes specified in sub-section (5) maintained specifically for such corpus" shall be substituted;

(ii) after Explanation 3, the following Explanations shall be inserted, namely:--

"Explanation 4.--For the purposes of determining the amount of application under clause (a) or clause

(b),-- (i) application for charitable or religious purposes from the corpus as referred to in clause (d) of this subsection, shall not be treated as application of income for charitable or religious purposes:

Provided that the amount not so treated as application, or part thereof, shall be treated as application for charitable or religious purposes in the previous year in which the amount, or part thereof, is invested or deposited back, into one or more of the forms or modes specified in sub-section (5) maintained specifically for such corpus, from the income of that year and to the extent of such investment or deposit; and

(ii) application for charitable or religious purposes, from any loan or borrowing, shall not be treated as application of income for charitable or religious purposes: Provided that the amount not so treated as application, or part thereof, shall be treated as application for charitable or religious purposes in the previous

year in which the loan or borrowing, or part thereof, is repaid from the income of that year and to the extent of such repayment.

Explanation 5.--For the purposes of this sub-section, it is hereby clarified that the calculation of income required to be applied or accumulated during the previous year shall be made without any set off or deduction or allowance of any excess application of any of the year preceding the previous year.”; (b) in sub-section (2), in the Explanation, after the figures and letters “12AA”, the words, figures and letters “or section 12AB” shall be inserted; (c) in sub-section (3), in clause (d), after the figures and letters “12AA”, the words, figures and letters “or section 12AB” shall be inserted.

Primarily related to the treatment of the corpus donation in the hands of the trust. Next is related to the treatment of Expenditure incurred out of borrowed funds. Final one is related to treatment of excess application of earlier years for adjustment in subsequent years.

A. Corpus Donations:

Trusts registered u/s 12AB are not allowed to accumulate more than 15% of their income (or in specific cases, accumulate to specific purpose up to 5 years) from the voluntary contributions other than corpus donations referred above in terms of Section 119 (1)(b) read with clause (2) of explanation-1 to Section 11.

As far as corpus donation is concerned, presently corpus donations received by trusts, institutions funds etc. is subject to the tax treatment as under:

1. a) Explanation to third proviso to Section 10(23C) provides that income of the fund or trust or institution or any university or any other educational institution or any hospital or other medical institution, shall not include income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus.

b) Section 11(1)(d) provides that voluntary contributions made with specific direction that they shall form part of the corpus of the trust or institution shall not be included in the total income of the trust or institution.

Though corpus donation is exempt, Trusts were eligible to claim it as part of the mandatory 85% application from income other than such corpus. Such treatment was effectively resulting in double deduction in the hands of the trusts. In order to ensure that there is no double claim by charitable institution while calculating application or accumulation, following amendments are proposed by way of insertion of sub clause(a) to explanation 2 to section 10(23C) and sub clause (a) or clause (b) of section 11:

2. Voluntary contributions made with a specific direction that it shall form part of Corpus are required to be invested or deposited in one or more of the forms or modes specified in sub section(5) maintained specifically for such corpus.
3. Application for charitable or religious purpose from the corpus as referred to in clause (d) of this subsection, shall not be treated as application of income for charitable or religious purposes. However, the amount not so treated as application, or part thereof, will be treated as application for charitable or religious purposes in the previous year in which the amount, or part thereof, is invested or deposited back, in to one or more of the forms or modes specified in sub section (5) maintained specifically for such corpus, from the income of that year and to the extent of such investment or deposit.

The modes in which income shall be accumulated for specific purpose are:

- Investment in government saving certificate/UTI
- Deposit in post office savings bank/scheduled bank.
- Investment in immovable property.
- Deposit with or investment in bonds of a public co. having main object of providing long term finance for urban infrastructure/industrial development/ residential house, in India
- Investment in Company debentures fully and unconditionally guaranteed by Central or State Government
- Investment or deposit in public sector company

B. Application in form of revenue/ capital expenditure out of Loans & borrowed funds:

There are instances where charitable activity is carried out by borrowed funds. At the first instance, when the expenses were incurred the benefit of application of income is taken by the trust. Few trusts were also taking further deduction at the time of repayment of the loan. Effectively, few trusts were claiming dual deduction in such cases. The matter was full of litigation and disputes which is now put to an end by Budget – 2021 wherein amendments are proposed by way of insertion of sub clause(b) to explanation 2 to section 10(23C) and sub clause (ii) to explanation 4 to section 11 for the purposes of determining the amount of application under clause (a) or clause (b) of section 11 which provides as under:

“Application from loans and borrowings shall not be considered as application for charitable or religious purposes for the purposes of third proviso of clause (23C) and clause (a) and (b) of Section 11. However, when loan or borrowing is repaid from the income of the previous year, such repayment shall be allowed as application in the previous year in which it is repaid to the extent of such repayment”

C. Adjustment of Previous years Excess Application against current years income:

“In order to provide certainty, it is proposed to clarify that charitable trusts shall not be permitted to claim carry forward of loss. However, the loan repayment and replenishment of corpus shall be allowed as application,” the Finance Minister, Nirmala Sitharaman in the budget speech said.

The Honourable Judiciary have already verdict that the trusts are eligible to set off excess application of earlier years against income of subsequent years. The issue already settled by the judiciary has been nullified by the proposals in Finance Bill 2021 by introducing new explanation -2 to Section 10(23C) and explanation – 5 to Section 11 as under:

1. For the computation of income required to be applied or accumulated during the previous year no set off or deduction or allowance of any excess application, of any of the year preceding the previous year shall be allowed.
2. This amendment have overruled the decision of Supreme Court in the case of CIT vs. Rajasthan and Gujarat Foundation,(2018) 300 CTR where in it was held that the deficit arising out excess of expenditure over income during the earlier previous year can be set off against the surplus income over expenditure relating to subsequent year.

Beneficial Amendment

The finance bill read as follows:

in clause (23C),-- (I) in sub-clause (iiid), for the words “receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed”, the words “receipts of the person from such university or universities or educational institution or educational institutions do not exceed five crore rupees” shall be substituted; (II) in sub-clause (iiiae),-- (A) for the words “receipts of such hospital or institution do not exceed the amount of annual receipts as may be prescribed; or”, the words “receipts of the person from such hospital or hospitals or institution or institutions do not exceed five crore rupees.” shall be substituted;

The prescribed limit for exemption to any person on behalf of university or educational institution/ hospital has been enhanced. The exemption is available to the referred entities if their annual receipt does not exceed the prescribed amount of Rupees One Crore. It is proposed to increase the prescribed limit from One Crore to five crore.

Conclusion

In the budget memorandum the proposed amendments relating to charitable trusts have been mentioned as ***Rationalisation of the provision of Charitable Trust and Institutions to eliminate possibility of double deduction while calculating application or accumulation.*** And there by the proposed amendment may check the evasion of taxes and malpractices by mis utilising the provisions. Since the tax concessions afforded to these institutions involve a sacrifice of public revenues, it became imperative to ensure that tax privileges are not abused and they are enjoyed only by those charitable and religious institutions, which deserve them.