

## Assessment of Charitable Trusts

### Background

The assessment of charitable trusts till Finance Act 2008, was an easy task, with most of the litigative issues being settled. However, due to the amendment carried out in the term “charitable purpose” under Sec 2(15), in the said Act, the Department started out with a vengeance, in cancelling registrations and rejecting applications for most of the cases, which fell under the residual head of “any other activity of public charitable nature”.

The main issues which came under the radar of the Department was:

1. Allowance of depreciation as an expenditure when the capital outlay was claimed as an application of income.
2. Calculation of standard deduction of 15% under Sec 11, whether it should be on gross income or net income.
3. Carry forward of excess application of income in earlier year(s) to be set off against the income in a subsequent assessment year.
4. Expenses incurred outside the country for importing items for a charitable purpose in India and the like.

The issue pertaining to depreciation and whether the income has to be gross or net was settled by way of an amendment to the Act.

### Reasons for the above Dispute

- ✓ The main reason which prompted the revenue to be aggressive in the above issues was not understanding the concept of income mentioned in the sections governing taxation of a charitable organisation.
- ✓ The taxation of a charitable undertaking is governed by Chapter III which is a separate code and not under Chapter IV which governs the taxation of various incomes under the respective Heads of Income.
- ✓ The thrust on the taxation schema is on application of funds and not on spending. There is a vast difference between the two.
- ✓ There is a schematic and conceptual difference and distinction between Chapter III and Chapter IV of the Income Tax Act.

*Now, in the succeeding paragraphs, let us understand the meaning of income as defined under section 11 of the Income Tax Act, 1961.*

## Section 11

Let us analyse the provision of Sec 11 of the Act (**only relevant portion**):

### **Income from property held for charitable or religious purposes.**

11. (1) Subject to the provisions of sections 60 to 63, the following income shall not be included in the total income of the previous year of the person in receipt of the income—

*(a) income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India; and, 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 fifteen per cent of the income from such property;*

*(b) income derived from property held under trust in part only for such purposes, the trust having been created before the commencement of this Act, to the extent to which such income is applied to such purposes in India; and, where any such income is finally set apart for application to such purposes in India, to the extent to which the income so set apart is not in excess of fifteen per cent of the income from such property;*

*(c) income derived from property held under trust—*

*(i) created on or after the 1st day of April 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and*

*(ii) for charitable or religious purposes, created before the 1st day of April 1952, to the extent to which such income is applied to such purposes outside India:*

*Provided 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) 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.*

### **Our Analysis**

Thus, on an analysis of the section we can see that the terminology used is **income** and **not total income**. Section 2(45) deals with total income, whereas the reference in **Sec 11** is only for income.

What we can infer and it is also interpreted by various decisions of the court that the **income means that which is left in the hands of the trust after meeting all expenses in earning the same (application of income)**.

Only such of the income, which is left after the expenditure, is required to be set apart or such of the amounts which is left with the trust after meeting necessary expenses can be spared for investment in securities. In short, it is the surplus, which is left with, which has to be reckoned for the purposes of arriving at the income.

## How should the Income under Sec 11 be computed?

Since the income referred to under Sec 11 is not total income under Sec 2 (45), Many Courts Have Interpreted The Same To Mean “*Income Derived On Commercial Principles*”.

Now let us know what does the income derived on commercial principle mean;

The term commercial principle is not defined under the Act. Recourse should be taken to the accounting parlance and the interpretation given by the courts. The question to be answered is that, whether the income is to be computed as per the provisions of the act under Sec 2(45) or under the rules of accountancy.

Since the term used in the section is income and not total income, the *rules of accountancy come into play*.

## Can Excess Expenditure in any year be Carried Forward?

Under accounting rules, in arriving at the income, as per commercial principles, depreciation has to be allowed, all expenses incurred for earning the same has to be deducted and more importantly, expenses incurred in earlier year will have to be regarded for the application against the income of the current year. In short, excess expenditure incurred in earlier year are allowed to be carried forward and set off in the subsequent year.

*However, the Income Tax Department is not allowing the set off of excess expenditure incurred in earlier years against the income of the subsequent year, holding that set off is not provided for.*

**The CBDT ALSO HAS understood such income to be in commercial principles in circular no 5p para no 4 dt june 19,1968. (REF: CIT V Sisters of ST Anne, (1984) 146 ITR 28. High Court of Karnataka.)**

**Section 11** of the Act does **not place any limitation** in providing that the income should have been applied for charitable or religious purposes only in the year in which such income is earned.

There is a difference in the term “**applied**” and “**expended**”. Applied means put to use and the application takes place in the year in which the income is adjusted to meet the expenses incurred for charitable purpose. Thus, even if the expenses incurred is in earlier year, the same can be adjusted for application in the subsequent year.

Even the circular issued by the department in **January 24,1973, F.NO.195/1/72-I.T.(A.I.)** subscribes to this principle in the case of repayment of loans.

Section 11, being a benevolent section, no curtailment of immunity from taxation can be imposed since many of them are doing or working along with the Government in helping the poor and downtrodden.

The **Return Of Income** under **Form 7** used for determining the income of a Charitable Trust has no provision for carrying forward of such excess expenditure incurred for set off, in the subsequent year when no limitation or curtailment is imposed by law.

**What the Act provides the rules cannot taketh away.** This anomaly in the Return has to be rectified by the Department in order to help genuine assesseees. Rules cannot override the Act.

The Courts in the following cases have **upheld the determination of income on commercial or business principle** which is binding on the department.

- a. CIT v Sisters of ST Anne, (1984) 146 ITR 28. High Court of Karnataka.
- b. CIT v Jayashree Charitable Trust (1986) 159 ITR 280 Cal.
- c. CIT v Programme for community Organisation (1997) 228 ITR 620 and subsequently affirmed by SC in (2001) 248 ITR 1.
- d. CIT v Rao Bahadur Calavala Cunnann Charities 1982 135 ITR 485 (MAD)
- e. CIT v Bhoruka Public Welfare Trust (1999) 240 ITR 513 Cal.
- f. CIT v Institute of Banking 264 ITR 110 (BOM)
- g. DIT v Viswa Jagruthi Mission ITA no 140/2012 dt 29/3/2012 Delhi High Court.

In the following cases, Courts have held that the **excess application of income in a year can be set off** against the income of the subsequent assessment year for the purpose of application of income.

- a. CIT V Gujarati Samaj (R). 2012 349 ITR 559 M.P.
- b. CIT V Maharana of Mewar Charitable Foundation 1987 164 ITR 439 (Raj)
- c. CIT V Sisters of ST Anne, (1984) 146 ITR 28. High Court of Karnataka.
- d. CIT V Shri PLOT Svetambara Murti Pujak Jain Man, 1995, 211 ITR GUJ,
- e. CIT v. Institute of Banking Personnel (264 ITR 110) (Hon.)
- f. DIT (Exemptions) v. Aditya Birla Vikram Memorial trust (ITA No. 1087 of 2014) (Bom.)
- g. DIT (E) v. M/s. Aditya Birla Foundation (ITA No. 1497 of 2014) (Bom.)
- h. Income-tax Officer vs. Trustees of Sri Sathya Sai Trust (33 ITO 320)
- i. DDIT (E) V Ohio University, I.T. A. Nos. 1075 & 1076/Bang/2014
- j. DIT (Exemptions) v. M/s. Aditya Vikram Memorial Trust ITA no. 1087 of 2014.

The judgement of Hon'ble Bombay High Court, in the case of **Institute of Banking Personnel 264 ITR 110**, which is a **landmark judgement** and is still holding the field, wherein the Hon. High Court has observed as under –

Now coming to Question No. 3, the point which arises for consideration is, whether excess of expenditure in the earlier years can be adjusted against the income of the subsequent year and whether such adjustment should be treated as application of income in subsequent year for charitable purposes?

It was argued on behalf of the department that expenditure incurred in the earlier year, Carry forward of excess of expenditure over income allowable in case of trust years cannot be met out of the income of the subsequent year and that utilization of such income for meeting the expenditure of earlier years would not amount to application of income for charitable or religious purposes.

In the present case, the assessing officer did not allow carry forward of the excess of expenditure to be set off against the surplus of the subsequent years on the ground that in the case of a Charitable Trust, their income was assessable under self-contained code mentioned in section 11 to section 13 of the Income Tax Act and that the income of the Charitable Trust was not assessable under the head "profits and gains of business" under section 28 in which the provision for carry forward of losses was relevant. That, in the case of a Charitable Trust, there was no provision for carry forward of the excess of expenditure of earlier years to be adjusted against income of subsequent years.

**"We do not find any merit in this argument of the department. Income derived from the trust property has also got to be computed on commercial principles and if commercial principles are applied then adjustment of expenses incurred by the Trust for charitable and religious purposes in the earlier years against the income earned by the Trust in the subsequent year will have to be regarded as application of income of the Trust for charitable and religious purposes in the subsequent year in which adjustment has been made having regard to the benevolent provisions contained in section 11 of the Act and that such adjustment will have to be excluded from the income of the Trust under section 11(1)(a) of the Act. Our view is also supported by the judgment of the Gujarat High Court in the case of CIT v. Shri Plot Swetamber Murti Pujak Jain Mandal (1995) 211 1TR 293 (Guj). Accordingly, we answer question No. 3 in the affirmative i.e., in favour of the assessee and against the department."**

It is also necessary to state that Hon'ble Bombay High court has dismissed the appeal of the Revenue in DIT(E) v. Gem & Jewellery Exports Promotion Council in ITA(LOD) No. 1113 of 2010 vide judgment dated 15.02.2011 by following the decision of Hon'ble Bombay High Court in the case of CIT v. Institute of Banking Personnel Selection (IBPS) (supra) on the issue of set off of deficit of earlier years against surplus of the impugned assessment year.

**The Revenue filed an SLP with Hon'ble Supreme Court which was dismissed by Hon'ble Apex Court vide orders dated 09.09.2011 in SLP(Civil) CC 13512/2011.**

SLP is filed by the Revenue against Hon'ble Bombay High Court judgment but as is observed, the said SLP also stood dismissed by Hon'ble Apex Court. Thus, we can see that the Hon'ble Courts/Tribunal had taken consistent stand that in case of Charitable Trust, excess expenditure over income is to be allowed to be carried forward for setting off against income of subsequent years.

Thus, it is our considered opinion that the carry forward of excess expenditure is allowed by Law and the same cannot be denied by Income Tax Rules and the Return of income under Form 7 has to be amended to include provision for carry forward of excess expenditure for the purpose of adjustment as application of income for the subsequent year.

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