Union Budget 2022 - A Mixed Bag for Charitable Trusts!

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The speech of the Hon'ble Finance Minister did not give any indication as to what was in store for charitable organisations. 'The devil is in the detail'. A perusal of the Memorandum Explaining the Provisions of the Finance Bill, 2022 would indicate that out of a total of 109 pages covering the provisions relating to direct tax, 22 pages explain the amendments made to the provisions governing trusts and other charitable institutions. An attempt is being made to discuss these amendments in this article.

Charitable entities be it trusts, societies or companies are essentially governed by the provisions of either section 11 to 13 of the Act (second regime) or are governed by sub-sections (iv), (v), (vi) and (via) of section 10(23C) of the Act (first regime) (collectively known as both the regimes). The amendments proposed by the Finance Bill, 2022 (the Bill) are with an aim of: (a) ensuring effective monitoring and implementation; (b) bringing consistency in the provisions of the two exemption regimes and providing clarity on taxation in certain aspects.

Maintenance of books of account (applicable from 1st April 2023 and would apply for AY 2023-24 onwards)

The Bill proposes to amend the tenth proviso to section 10(23C) and Section 12(1)(b) of the Act to provide that where the total income of the trust or institution under both regimes, without giving effect to the provisions of clause (23C) of section 10 or section 11 and 12, exceeds the maximum amount which is not chargeable to tax, such trust or institution shall keep and maintain books of account and other documents in such form and manner and at such place, as may be prescribed.

This seems to be an innocuous amendment as for getting an audit done, maintenance of books of account is a sine qua non. The condition of getting an audit done could never have been complied with by the trusts or institutions without maintenance of books of account. Be that it may, this amendment proposes to provide explicitly what was being followed impliedly.

Cancellation of registration/approval (applicable from 1st April 2022)

The memorandum to the Bill provides that at present there exists a provision under section 10(23C) for cancellation of registration/approval of an institution however, no such specific provision exists under sections 11 to 13 of the Act. It also provides that there is no time limit under which the PCIT/CIT has to act upon any reference that has been made to them for cancellation. Accordingly, the Bill proposes to amend the provisions of section 12AB and fifteenth proviso to clause (23C) of section 10 of the Act to provide for a specific procedure for cancellation of the registration of the trust or the institution as the case may be.

As per the proposed sub-section (4) and (5) of the Section 12AB and fifteenth proviso to section 10(23C) of the Act, after granting of registration or provisional registration of a trust or an institution, if occurrence of specified violation comes to the notice of Principal Commissioner or Commissioner or reference has been made to him by the assessing officer or such case has been selected in accordance with the risk management strategy, formulated by the Board from time to time, for any previous year, the PCIT or CIT may pass an order either cancelling the registration or refuse to cancel the registration after following the procedure detailed below:

(i) call for such documents or information from the trust or institution or make such inquiry as he thinks necessary in order to satisfy himself about the occurrence or otherwise of any specified violation;

(ii) pass an order in writing cancelling the registration of such trust or institution, after affording a reasonable opportunity of being heard, for such previous year and all subsequent previous years, if he is satisfied that one o more specified violation have taken place;

(iii) pass an order in writing refusing to cancel the registration of such trust or institution, if he is not satisfied about the occurrence of one or more specified violation;

(iv) forward a copy of the order under clause (ii) or (iii), as the case may be, to the Assessing Officer and such trust or institution

The above procedure needs to be completed before the expiry of the period of *six months*, calculated from the end of the quarter in which the first notice is issued by the PCIT or CIT him on or after the 1st day of April, 2022.

The term “specified violation” has also been exhaustively defined by inserting an Explanation to sub-section (4) of section 12AB of the Act. Specified violation means:

(a) where any income of the trust or institution under the second regime has been applied other than for the objects for which it is established; or

(b) the trust of institution under the second regime has income from profits and gains of business which is not incidental to the attainment of its objectives or separate books of account are not maintained by it in respect of the business which is incidental to the attainment of its objectives; or

(c) the trust or the institution under the second regime has applied any part of its income from the property held under a trust for private religious purposes which does not enure for the benefit of the public; or

(d) the trust or institution under the second regime established for charitable purpose created or established after the commencement of this Act, has applied any part of its income for the benefit of any particular religious community or caste;

(e) any activity being carried out by the trust or the institution under the second regime,

(i) is not genuine; or

(ii) is not being carried out in accordance with all or any of the conditions subject to which it was registered; or

(f) the trust or the institution under the second regime has not complied with the requirement of any other law, as referred to in item (B) of sub-clause (i) of clause (b) of sub-section (1) of section 12AB, and the order, direction o decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality.

Similar provisions are also proposed to be inserted by way of an explanation to the fifteenth proviso to section 10(23C) of the Act. Further it is proposed to amend section 143(3) to provide that where the Assessing Officer is satisfied that any trust or institution has committed a specified violation, he shall send a reference to the PCIT/CIT. Accordingly, it has been provided that the period commencing from the date of making reference to the communication of the order of refusal/cancellation of registration/approval/notification passed by principal commissioner or commissioner shall be excluded in computing the period of limitation [*Clause (iii) of Explanation to section 153*].

It is important to note that vide Finance Act, 2020, section 12AB was made effective from 01.04.2021 and procedure of cancellation was enacted in sub-section (4) and (5) to Section 12AB of the Act. However, after coming into effect only for a year, the government has proposed to substitute the existing sub-section (4) and (5) of the said section. The proposed insertions by the 2022 Bill do provide for clarity and would ensure parity between the two regimes but at the same time suggests that the changes made hitherto were not thought through in the past.

Application of income on actual payment basis (Applicable from 1st April 2022 and will apply to AY 2022-23 onwards)

At present trusts and other institutions are free to choose the method of accounting i.e. cash or accrual for the purpose of maintenance of the books of account. However, in case of a company, the Companies Act 2013 mandates maintenance of books on accrual basis.

As per the proposed amendment, application of income can now be claimed only on paid basis irrespective of the method of accounting regularly employed. This change is sought to be made by inserting *Explanation 3 to clause (23C) of section 10 and an Explanation to section 11*. It is also proposed to provide that application once claimed in respect of any amount in any previous year cannot be claimed in any subsequent previous year.

The reason given purportedly by the Memorandum to the Bill is that application means ‘actually paid’ and that the courts have also held the same. It needs to be noted that there are many judicial precedents that have also held that ‘application’ does not mean ‘actual payment’. The Andhra Pradesh High Court and the Allahabad High Court in the case of *CIT v Trustees of H.E.H The Nizam’s Charitable Trust*[1] and in the case of *CIT v Radhaswami Satsang Sabha*[2] have held that ‘Applied’ need not be equated with ‘Spent’. Therefore, the proposed change will result in the trusts and institutions either changing their method of accounting to cash basis or follow a hybrid system of accounting as no clarification has been given regarding the treatment of income of the charitable trust or institution thereby charitable entities which are governed by the Companies Act are going to be most affected by this amendment as they are mandated to follow the accrual basis of accounting. For tax purposes they would need to rework the application on cash basis. Why unsettle a settled position? Another aspect which needs to be noted in this connection is that this proposed amendment would be applicable from AY 2022-23 and to that extent it is retrospective.

Taxation of certain income at special rate and consequences of passing on unreasonable benefits to trustee or specified persons (applicable from 1st April 2023 and would come into effect from AY 2023-24)

At present income arising on account of passing any unreasonable benefit to the trustee/specified person or income arising on account of funds not being kept in specified modes and income arising on account of application being less than 85% of the income of the year is taxable under both the regimes but under different provisions.

In order to provide consistency and certainty in the manner of taxation of income in the above situations, it is proposed that the registration shall not be cancelled but such income would be taxable at a special rate of 30%. The following amendments are proposed in this regard:

(a) amend clause (c) of sub-section (1) of section 13 of the Act to provide that only that part of income which has been applied in violation to the provisions of the said clause i.e. applied directly or indirectly for the benefit of specified persons referred to in section 13(3), shall be liable to be included in total income.

(b) insert twenty first proviso in clause (23C) of section 10 to specifically provide that where the income of any trust under the first regime, or any part of the such income or property, has been applied directly or indirectly for the benefit of any person referred to in sub-section (3) of section 13, such income or part of income or property shall be deemed to be income of such person of the previous year in which it is so applied. The provisions of sub-section (2), (4) and (6) of section 13 of the Act shall also apply to it.

(c) amend clause (d) of sub-section (1) of section 13 of the Act to provide that only the that part of income which has been invested in violation to the provisions of the said clause shall be liable to be included in total income.

(d) insert Explanation 4 in third proviso to clause (23C) of section 10 of the Act to specifically provide that income accumulated which is not utilised for the purpose for which it is so accumulated or set apart shall be deemed to be the income of such person of the previous year being the last previous year of the period, for which the income is accumulated or set apart.

(e) insert a new section 115BBI in the Act providing that where the total income of any assessee being a trust under the first or second regime, includes any income by way of any specified income, the income-tax payable shall be the aggregate of—

(i) the amount of income-tax calculated at the rate of thirty per cent on the aggregate of specified income; and

(ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the aggregate of specified income referred to in clause (i).

(f) The sub-section (2) of this new section seeks to provide that no deduction in respect of any expenditure or allowance or set off of any loss shall be allowed to the assessee under any provision of the Act in computing specified income.

(g) Explanation to the proposed section defines “specified income” to mean:-

(i) income accumulated or set apart in excess of fifteen percent of the income where such accumulation is not allowed under any specific provisions of the Act; or

(ii) deemed income referred to in Explanation 4 to third proviso to clause (23C) of section 10 or sub-section (3) of section 11 or sub-section (1B) of section 11;or

(iii) any income which is not exempt under clause (23C) of section 10 on account of violation of the provisions of clause (b) of third proviso of clause (23C) of section 10 or not to be excluded from total income under the provisions of clause (d) of sub-section (1) of section 13; or

(iv) any income which is deemed to be income under the twenty first proviso to clause (23C) of section 10 or which is not excluded from total income under clause (c) of sub-section (1) of section 13; or

(v) any income which is not excluded from total income under clause (c) of subsection (1) of section 11

Further, penalty under section 271AAE of the Act has been proposed which shall be equal to amount of income applied by such trust or institution for the benefit of specified person where the violation is noticed for the first time during any previous year and twice the amount of such income where the violation is notice again in any subsequent year. Penalty under this section is proposed to operate without prejudice to any other provision of chapter XXI.

This is a welcome amendment as it was extremely harsh to deny exemption on account of minor defaults. The proposed provisions provide clarity as well as a deterrent in the form of a penalty.

Allowing certain expenditure in case of denial of exemption in specified circumstances (applicable from 1st April 2023 and would apply from AY 2023-24 onwards)

At present there is a lack of clarity on how the income needs to be taxed if exemption is denied on account of the following violations:

(a) Having commercial receipts in excess of 20% of the annual receipts in violation of the provisions of proviso to section 2(15);

(b) Not getting the books of account audited;

(c) Not filing the return of income presently specifically provided under the second regime only;

Therefore, in order to provide clarity it is proposed to insert sub-section 10 to section 13 of the Act, to provide that If due to application of proviso to section 2(15) of the Act *or not getting the books of account audited or return of income not been filed* within specified time, exemption under section 11 and 12 of the Act would be denied and income would be assessed after allowing deduction for the revenue expenditure incurred in India, for the objects of the trust or institution, subject to the condition of such expenses not being met from opening corpus or any loan or borrowing or not in the form of any contribution or donation to any person and that claim of depreciation is not in respect of an asset, acquisition of which has been claimed as an application of income in the same or any other previous year.

The provisions of sub-clause (ia) of clause (a) of section 40 and sub-sections (3) and (3A) of section 40A, shall, mutatis mutandis, apply. No deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any other provision of the Act.

Similar provisions are proposed to be inserted to regulate the entities covered under section 10(23C) of the Act.

This is again a welcome provision as it provides certainty to the taxation regime and does not lead to denial of the entire expenditure incurred by the trust or the institution.

Time limit to utilize the income set apart or accumulated under section 11(2) of the Act (applicable from 1st April 2023 and will apply for AY 2023-24 onwards)

As present, there is a disparity between the accumulation provisions under both the regimes. Under section 10(23C) of the Act, income accumulated is taxed in the fifth year itself whereas in case of trusts, accumulated income if not spent is taxed in the sixth year. Further, under section 10(23C) there is no provision to file a specified form for the purposes of accumulation as there is under section 11(2) of the Act.

It is accordingly proposed that in case of trusts unspent accumulated income would be taxed in the fifth year itself and explanation 3 to the third proviso to section 10(23C) is being inserted to provide for conditions which institutions would have to follow to avail the benefit of the accumulation provisions.

Consider a case where a trust accumulates its income for FY 2016-17 for 5 years. As per the existing provisions it would need to spend such income till 31st March 2022. Any unspent amount would get taxed in FY 2022-23. As the proposed amendment is applicable from 1st April 2023 so in this case there seems to be no difficulty but as regards unutilized amounts which have been accumulated or set apart in FY 2017-18, there appears to be an issue. From a plain reading of the existing provisions together with the proposed amendment it seems that as 5 years end on 31st March 2023 i.e. the unutilized amount would get taxed in FY 2022-23. Hitherto the trust would have got one more year to spend the unutilized amount and the balance amount would have got taxed in FY 2023-24 i.e. the 6th year. To this extent this amendment even though effective from AY 2023-24 is retrospective in its application as it curtails the period of spending/prepones the year of taxability in cases of trusts which would have accumulated income under section 11(2) of the Act basis the existing law.

Voluntary contributions for the renovation and repair of temples, mosques, gurudwaras, churches etc.(applicable from 1st April 2021 and will be applicable from AY 2021-22 onwards)

The memorandum to the Bill provides that at present, there is no clarity on whether these donations are to be taken as corpus donations or are required to be applied in the ordinary course. Accordingly it is being provided that

Voluntary contributions received for the purpose of renovation or repair of any temple, mosque, gurdwara, church or other place notified under clause (b) of subsection (2) of section 80G of the Act and held under a trust or institution, may at the option of trust be treated as corpus of the trust or the institution, subject to fulfilment of certain conditions. Further, such sum shall be deemed to be the *income* of such trust or institution of the previous year during which the violation of the prescribed conditions takes place.

The law as regards donations was very clear. If the donation was to be treated as part of the corpus then the donor had to specify that the donation is being made for the corpus. If no such direction was given by the donor then such donation would form part of the general fund or common pool available to the trust. There was no need to amend the law on this aspect. Further, if at all the law had to be amended then it should have been done prospectively and not retrospectively. How can a trust take money to its corpus retrospectively is not clear?

Vide Finance Act 2020, Explanation 4 was added to section 11 wherein it was provided that for the purposes of determining the amount of application, amount spent from the corpus shall not be treated as an application of income. The same would be treated as application in the previous year when the amount initially spent from the corpus is invested back into the specified forms of investment as per section 11(5) maintained for such corpus. A conjoint reading of the amendments made last year to the provisions considering the application of income from corpus and the current proposed amendments it seems that the intention of the Government is that if the sum received is treated as corpus then no application would be allowed if such sum is used for repairs or renovation. As and when the corpus is recouped then such amount would be allowed as an application in that year. If the amount received is treated as a general donation then the provisions of spending 85% and accumulation would apply.

The provisions of section 115TD to apply to any trust or institution covered under section 10(23C) (applicable from 1st April 2023 and would apply for AY 2023-24 onwards)

At present upon winding up of the activities of a trust covered under section 11 of the Act, an exit tax is levied under Chapter XII-EB of the Act. No such provision exists for institutions governed under section 10(23C) of the Act. In order to bring parity between the two regimes it is proposed to amend the provisions of section 115TD, 115TE and 115TF of the Act to make them applicable to any trust or institution governed by section 10(23C) of the Act under the first regime as well.

This amendment was long overdue as it gave advantage to institutions governed under section 10(23C) of the Act over the trusts governed by section 11 of the Act.

Filing of return by persons claiming exemption under section 10(23C) (applicable from 1st April 2023 and will apply AY 2023-24 onwards)

A trust governed by the provisions of section 11 of the Act is obligated to file its return of income in accordance with the provisions of section 139(4A) of the Act, however there is no such mandatory requirement in case of institutions covered under section 10(23C) of the Act. Accordingly, an amendment is proposed wherein such institutions would have to file a return of income in accordance with provisions of section 139(4C) of the Act.

Conclusion

It's a mixed bag for the trusts and institutions. There are certain amendments which are beneficial as they do provide clarity and bring certainty in terms of application of the law but the amendment pertaining to application to be considered on payment basis will lead to more complexity. This is because if the accounts are drawn up on accrual basis a reconciliation would be required to be made each year to claim application on actual payment basis. From the last few years, the NGO sector has been under the scanner be it by the FCRA authorities or the tax authorities. The provisions under the FCRA have also been recently amended and are very stringent. The Government should be mindful of the good work being done by the NGO sector and should resist bringing amendments which paint all such institutions with the same brush.

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[1] [TS-5059-HC-1981(ANDHRA PRADESH)-O]

[2] [TS-5113-HC-1953(ALLAHABAD)-O]