

Recent Circular on Charitable Trust Benefit

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Condition 1 –Registration under 12A

- The provisions of section 11 and 12 will not apply to a trust unless it is registered under section 12A.
- Earlier the registration under section 12A was perpetual once the same was granted unless cancelled by the Principal Commissioner. This led to the difficulty where the department was to identify the trust which were not operating properly.
- The provisions have changed by Finance Act 2020 from 1-4-21(A.Y. 2021-22) and all trusts have to register again by filling form online in form 10A. The registration was to be issued for a period of five years(three years for trust who were taking first time registration).
- **Consequences of non registration or rejection:-** Trust which was previously registered and failed to get registration due to any reason would have pay tax under Chapter XII-EB, S115TD tax Tax on accreted Income. In case the trust has not taken registration it will be taxed as an AOP and will not get exemption under section 11

Condition 2:- Maintenance of Books

- The law earlier was not specific about the maintaining of books by a trust. The act provided for audit of books of accounts of the trust.
- The Finance Act 2022 from A Y 2023-24 amended sub clause (b) to section 12A and the trust is now required to maintain the prescribed books of accounts.
- The government has notified on 10th August 2022 amended the rules and notified Rule 17AA prescribing the books of accounts to be notified. There are more than 50 items listed, it would be practically very difficult for a trust to maintain such documentation.
- **Consequences of non maintenance of books:-** The Benefit under section 11 will be denied for the year in which such error is made.

Condition 3:-filling of audit report

- The trust were required to get the books of accounts audited and file an audit report in a form 10B (old) before the due date. The form was simple, but did not seek much detail.
- The government notified the new forms 10B and 10BB vide notification **7/2023/F. No. 370142/47/2023-TPL** G.S.R.118(E) on 21st February 2023.
- The form 10B had 49 clauses and 29 schedules.
- The form 10BB had 32 clauses and seven schedules.
- The forms required extensive data, there was great confusion about which form to use and how to reconcile the details with the return of income. In spite of representations the forms were implemented in the form notified and the professionals worked night and day to comply with the dictat.

Selection of form

- The notification provided the following conditions for selecting audit form.
- A detailed Form 10B is to be filled by the following –
 - the total income of such fund or institution or trust or university or other educational institution or hospital or other medical institution, without giving effect to the provisions of the sub-clauses (iv), (v), (vi) and (via) of the said clause, **exceeds rupees five crores during the previous year**; or
 - such fund or institution or trust or university or other educational institution or hospital or other medical institution **has received any foreign contribution during the previous year**; or
 - such fund or institution or trust or university or other educational institution or hospital or other medical institution **has applied any part of its income outside India during the previous year**;
- Form No. 10BB in other cases

Issues in selecting form

- The definition of “foreign contribution” received. Would the interest on foreign contribution would be also a treated as foreign contribution?
- The Total income of the trust, what is to be included to calculate the Rs 5 crore limit. Do you include the corpus donations also?
- When can it be said that the trust has “**applied any part of its income outside India during the previous year**”. The salary paid to a teacher abroad for taking lecture for students in India?
- The forms were filed by the auditors based on the their understanding of the law.

Section 10(23C) proviso 10

- [Provided also that where the total income of the fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via), *without giving effect to the provisions of the said sub-clauses, exceeds the maximum amount which is not chargeable to tax in any previous year*, such fund or institution or trust or any university or other educational institution or any hospital or other medical institution shall,—
- (a) keep and maintain books of account and other documents in such form and manner and at such place, as may be prescribed⁸⁸; and
- (b) get its accounts audited in respect of that year by an accountant as defined in the Explanation below sub-section (2) of section 288 before the specified date referred to in section 44AB and furnish by that date, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed⁸⁹.]

Circular 2 dated 5th march 2024.-I

- There were notices received from the CPC Bangalore to various trusts pointing out that they had filed form 10B instead of 10BB and hence there is non compliance and likely to be an adjustment.
- This error in filing form in certain cases was on account of misunderstanding the provisions or complete ignorance and in certain cases the system was taking a view different from the auditor.
 - One such case was where there was no receipt of FCRA but there was interest received, since the receipt of interest was treated as an FCRA receipt and form 10B was filed. However, the interest is shown with other interest so the system picks the case saying form 10BB is to be filed.
 - There is a receipt of foreign contribution, with out registration. Form 10B was filed. The CPC has raised a objection, as the FCRA number is not mentioned stating that form 10BB was to be filed

Circular 2 dated 5th march 2024.-II

- In some cases the trust has written that the form 10B contains all details as required under form 10BB and therefore the return should be processed.
- The trust had filed the form 10BB/10B late after it was pointed, after the return. They have applied to the PCIT for condonation in filing the audit report late.
- In some cases the reply was given that the view taken by the trust was correct as the form 10B/ 10BB was applicable.
- These returns in most cases have not been processed by CPC. Processing them would have created demand in these cases as exemption under section 11 or 10(23C) would have been denied. Hence the circular.

Circular 2 dated 5th march 2024.-III

- Para 7
- “7. It has come to the attention of the Board that in a number of cases trusts / institutions have furnished audit report in form 10B where form 10BB was required to be furnished for the A. Y. 2023-24. Similarly, in a number of cases the trusts / institutions have furnished audit report in form 10BB, where form 10B was required to be furnished for the A. Y. 2023-24.

As noted above, non filling of audit report in the prescribed form would result in denial of exemption in such cases as it is one of the conditions which is required to be satisfied for claim of exemption.”

Circular 2 dated 5th march 2024.-IV

8. In view of the above, the Central Board of Direct Taxes, in exercise of its powers under section 119 of the Act hereby allows those trusts / institutions which have furnished audit report on or before 31st October, 2023 in Form No. 10B where Form No. 10BB was applicable and vice-versa, to furnish the audit report under clause (b) of the tenth proviso to clause (23C) of section 10 and sub-clause (ii) of clause (b) of sub-section (1) of section 12A of the Income-tax Act, 1961, **in the applicable Form No. 10B / 10BB** for the assessment year 2023-24, on or before 31st March, 2024.

Issues.

- This is only for trusts who have filed their audit report on time. Those who have failed to file in time are not covered and will not get benefit of this circular.
- The form has to be filed **before 31st March 2024**, for getting benefit under section 11. This is a advantage given as this is the first year and there was pressure of compliance. In some cases the form 10B /10BB is filed in follow the previous year format, without looking at the amendment. We as auditor need to be more cautious as it will lead to disciplinary action.
- The cases where notices have been received, the auditor can file the form, but this should be taken as an opportunity to revisit the form and see that the correct form is filed.
- The processing of the return is likely to be an issue in such cases as the return file will have the details of old form.

Circular 3 dated 6th March'24

Does it solve or complicate the issue?

Condition 4:- Application of funds

- The exemption under section 11 is available only if the income from property of the trust is applied for charitable and religious objects of the trust to the extent of 85%.
- The accumulation of income is allowed only up to 15% of the income.
- The section provides exemption in certain cases, where either the funds are not received or due to any reason the funds could not be used in that year, subject to filling of form 9A online. The amount will have to be applied in the year of receipt of income or in the following year in case of any other reason.
- The section also provides for accumulation for a period of five years for a project, subject to the accumulation being invested in the modes provided under section 11(5) and filling of form 10 online.

Observations of CAG in its report no.12 of 2022 –leading to amendment in law

- AYs 2014-15 to 2017-18., **Audit Sample size 5798 cases**
- The IT Act has no provision to restrict donations by a Trust to another Trust out of current years' income. Therefore, certain Trusts/Institutions are taking undue benefits by availing of the permissible accumulation of 15 per cent out of the current year's income and then transferring the rest of the income to others trusts, and thereby making a chain of multiple donations. **Audit noticed in four assessment cases that the Trusts/Institutions, which had received donations of ` 203.29 crore, had transferred ` 164.81 crore to other Trusts/Institutions by way of donations after claiming deduction of 15 per cent as accumulation.** The recipient Trusts/Institutions also transferred the amounts to other trusts after claiming accumulation of 15 per cent. This chain of donation resulted in denial of charity to the beneficiaries and helped in accumulation in the hands of Trusts/Institutions.
- (Paragraph 5.1.2.7)

Amendment to the law in Finance Act 2023

- ***Explanation 4 to S. 11(1) amended and the following clause added.***
- *“(iii) any amount credited or paid, **other than the amount referred to in Explanation 2**, to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10, as the case may be, or other trust or institution registered under section 12AB, as the case may be, shall be treated as application for charitable or religious purposes **only to the extent of eighty-five per cent** of such amount credited or paid.”*

Amendment to 10(23C)

- *Clause (iii) in explanation 2 to third proviso of clause (23C) of section 10*
- *“(iii) any amount credited or paid out of the income of any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via), other than the amount referred to in the twelfth proviso, to any other fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via), or trust or institution registered under section 12AB, as the case may be, shall be treated as application for charitable or religious purposes only to the extent of eighty-five per cent of such amount credited or paid.”*

Issues with the amendment

- The law prior to amendment provided that donation (other than corpus donation) by trust / eligible institution to another trust / eligible institution is considered as application of income.
- The amendment would lead to a peculiar situation where trust would have to pay tax though the amount is applied.
- Example a trust has receipts of Rs 10,00,000/-. It has donated to other trusts Rs 5,00,000/- for a project to be done on the object which is common to both trusts. It has further spend an amount of 3,50,000/- as direct donations to needy persons. It has Rs 1,50,000/- unspent amount.
- From A Y 2024-25, the trust will have to pay tax on the unspent amount calculated as under.
- $(10,00,000 - ((85\% \text{ of } 500,000/-) 425,000) - (350,000) - (1,50,000(10,00,000 * 15\%)))$
Rs 75000 at 30% as per 115BBI as this is specified Income.

Representation.

- A lot of representation was made to the government on the issue.
- However the government was unwilling to move back as the said amendment, was a anti abuse measure.
- The amendment would create a lot of difficulty for smaller trusts who use funds by giving donation to deserving trust to achieve their aim of charitable activity.
- The trusts would have to change the way they operate so that the tax is not payable by the trust.

Difficulty faced

- Example a trust 'ABC' has medical objects. It has a tie up with the service wing of a public hospital run by the municipality. The hospital service wing a trust/NGO 'XYZ' has a list of patients who need funds for medical treatment at the hospital and also a list of trusts who have donated earlier and are willing to donate.
- The trust 'ABC' regularly gets approached by the service wing trust 'XYZ' who provides a list of patients and the trust provides donations for medical treatment.
- The 'ABC' trust donates to the service wing for the patients, but is not able to pay the complete cost of treatment and so pays only part of the amount.
- The NGO 'XYZ' at the hospital simultaneously approaches the other donors and the total amount is collected from four donors. The NGO gets the operation done and issues a utilization letter to the trust along with the receipt.
- The trust ABC will not get deduction of 85% of donation paid from A. Y. 24-25. Leading to difficulty. The transaction will have to be tweaked.
- The trust ABC will have to request for receipt in the patient name of the amount donated by it and will have to see that the name of patient is also mentioned in the receipt. A copy of the application for help will also have to be kept.

Circular 3:- A way out Para 4 of Circular 3

4. The matter has been examined with reference to the issues raised in paragraph 3 and it is reiterated that eligible donations made by a trust / institution to another trust / institution under any of the two regimes referred to in para 2 shall be treated as application for charitable or religious purposes only to the extent of 85% of such donations. It means that when a trust / institution in either regime donates Rs. 100 to another trust / institution in either regime, it will be considered to have applied 85% (Rs. 85) for the purpose of charitable or religious activity. It is clarified that 15% (Rs. 15) of such donations by the donor trust / institution shall not be required to be invested in specified modes under section 11(5) of the Act as the entire amount of Rs. 100 has been donated to the other trust / institution and is accordingly eligible for exemption under the first or second regime.

Examples given in the circular-Trust 1

- The circular gives relief in the form that the 15% for which benefit of application is not provided need not be considered for the calculation of 15% as the same is already invested.

- | Sr.No. | Particulars. | As per circular | As per circular | As per Law. |
|--------|-------------------------------|-----------------|-----------------|-------------|
| 1 | Income | 300 | | 300 |
| 2 | Income to be applied | | 255 | |
| 3 | Donation given to other trust | 100 | | |
| 4 | Deemed application | | 85 | 85 |
| 5 | Balance | 200 | | 215 |
| 6 | Amount applied from balance | | 170 | 170 |
| 7 | Amount to be accumulated | | 30 | 45 |

Examples given in the circular-Trust 2 & 3

		Trust 2			Trust 3		
Sr.No.	Particular	As per circular	As per circular	As per law	As per circular	As per circular	As per law
1	Income	100		100	100		100
2	Income to be applied		85			85	85
3	Donation given to other trust	100			0		
4	Deemed application		85	85		0	
5	Balance	Nil	Nil	15	100		
6	Amount applied from balance		Nil	15		85	85
7	Amount to be accumulated		Nil	15		15	15

The Trust 2 does not have the Rs 15 to accumulate and hence the said 15 as per the provisions would have been taxable. This difficulty is being removed by the circular. Is the circular as per law? Can it be directly against the law?

Analysis of the circular

- The amendment was with a specific purpose, to avoid the trusts taking benefit of 15% in a manner that the effective application of funds is avoided.
- The CAG report specifically gave example of 4 trusts in interior Maharashtra.
- The intention was to curb the mischief being done by misuse of the provisions of law.
- Thus the mischief rule would apply and any interpretation which would negate the purpose of the amendment should be avoided.
- Circular seems to suggest complete reversal of the amendment. Can a circular be issued in violation of the law? More so when it is to curb mischief. Let us consider the example in the CAG report.

CAG report example

Sr. No	Particulars	Trust 1		Trust 2		Trust 3		Trust 4	
1		Circular	Law	Circular	Law	Circular	Law	Circular	Law
2	Income	200	200	170	170	144.50	144.50	122.83	122.83
3	Application to be made	170	170	144.50	144.50	122.83	122.83	104.41	104.41
4	Given to trust 2/3/4	170	170	144.50	144.50	122.83	122.83	104.41	104.41
5	Amount deemd to be applied (85% of 4)	144.50	144.50	122.83	122.83	104.41	104.41	88.75	88.75
6	Balance to be accumulate (2- 4)	30		25.50		21.67		18.42	
7	Balance to be accumulate (2-5)		55.50		47.17		40.09		34.08
8	Accumulated	30	30	25.50	25.50	21.67	21.67	18.42	18.42
9	Taxable amount (7-8)		25.50		21.67		18.42		15.66

Impact of circular

- The circular effectively nullifies the impact of the amendment made by the Finance Act 2023.
- It is to be noted that the parliament thereafter passed the Finance Act 2024 which also did not bring about change in the provision.
- The CBDT now brings a circular which effectively reverse the provision, which is a to avoid misuse of law.
- The judgment of ACIT vs Ahmedabad Urban Development Authority (2022) 143 Taxmann.com 278 held that circulars in violation of law are not binding on department. Analysis of SC finding is reproduced hereunder.

ACIT vs Ahmedabad Urban Development Authority (2022)

- **Circulars issued by the CBDT**

- (a) Circulars are binding upon departmental authorities, if they
 - (i) advance a proposition within the framework of the statutory provision.
 - (ii) accord with and are not at odds with the statute

(b) If they are contrary to the plain words of a statute, they are not binding and are to be ignored (by the tax department also).

(c) (i) they cannot bind the courts, which have to independently interpret the statute, in their own terms.

(ii) at best they may be considered as departmental understanding on the subject and have limited persuasive value. (para123).

Difficulty for trusts

- The law as laid down by the SC in AUDA (supra) is obiter dicta as it ignores certain earlier judgment.
- The section 119 of the Income Tax Act under which the circular is issued, can be used to give benefit to the assessee if there is a difficulty face.
- Thus the power to condone the late filling of return or the filling of certain forms, is completely against the law laid. However the power is given to provide relief in appropriate cases. Thus it can be argued that the circular for benefit is valid.
- However, the circular has gone to nullify the law which was made to curb mischief and hence if challenged would lead to difficulty

Way forward

- We should take benefit as per the circular
- If there is a challenge there is a bonafide belief as the circular is issued by a statutory body.
- No penalty can be levied, but interest could be levied. However, one can go for waiver of interest to the PCIT as the circular is issued by the department and the trust has not actually earned the interest at 18%. (other view possible, PCIT may not accept the contention)
- A mess is created due to the refusal of the government to reverse the amendment knowing fully well it will create difficulty. A similar view is taken in case of 45(4) and 9B read with rule 8AA where also the whole provision of law is difficult to understand and implement.
- The **new ITR in Schedule A notified on 1-3-24** has amended clause (1) and added clause (1a) which specifically calculates 85% on donations to other trust. It will have to be seen how processing is done?

Questions ?

Asking questions is one of the best forms of learning.

Thank you

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