

New Tax Regime for Charitable Trusts Under Direct Tax Code Bill, 2009

Nisha Bhandari

As per the promise of the Finance Minister, the draft of new Direct Tax Code has been opened for public view. The Direct Tax Code has proposed significant changes in the taxation of charitable trusts. The code provides for taxation for Non Profit Organisations. As the charitable trusts would now be a part of NPO and hence its taxation will be governed by chapter IV of the code which provides for computation of total income of NPO. The learned author highlights the scheme of computation of total income of charitable trusts and its taxation under the new Direct Tax Code Bill, 2009.

1. Introduction

A long awaited Direct Tax Code (DTC) has finally been opened for public opinion. The proposed Direct Tax Code contains 16 chapters comprising 285 sections. Chapter IV of the DTC deals with special provisions relating to computation of total income of Non Profit Organisation. Under the present Income Tax Act, sections 10(23C) and 11 to 13 deal with provisions relating to exemption to charitable trusts and institutions. Under the new code sections 86 to 96 deal with provisions relating to Non Profit Organisation which includes charitable trusts.

2. Charitable purpose to be called 'permitted welfare activity' under new code

The definition of 'Charitable purpose' is provided in clause (15) of section 2 of the present Income Tax Act. Under the DTC charitable purpose has been renamed as 'permitted welfare activity'. As per clause (g) of section 96 of the DTC, the term "permitted welfare activity" means any activity,—

- (i) involving the relief of the poor;
- (ii) for the advancement of education;
- (iii) for providing medical relief;
- (iv) for the preservation of environment (including watersheds, forests and wildlife);
- (v) for the preservation of monuments or places or objects of artistic or historic interest; or
- (vi) for the advancement of any other object of general public utility;

As per clause (b) of section 96 "advancement of any other object of general public utility" shall not be a permitted welfare activity if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess, fee or any other consideration, irrespective of nature of use, application or retention, of the income from such activity.

The definition thus covers almost similar activities as provided in definition of the term 'charitable purpose' under section 2(15), though name has now been changed and to be called as "permitted welfare activities".

3. Income of charitable trust to be taxed at the rate of fifteen percent

The first schedule of the DTC provides rate of income tax. As per para C of item (1) of this schedule, the total income of NPO shall be chargeable to tax at the rate of 15 per cent. The total income of NPO shall be computed in the manner provided in sections 88 to 90.

4. Computation of total income chargeable to tax

The total income of any NPO shall be the aggregate of the following income—

- (i) income from permitted welfare activities, and
- (ii) income arising from transfer of any financial asset.

The income from such permitted welfare activities shall be the gross receipts, during the financial year, as reduced by the amount of outgoings in relation to the activities, calculated in accordance with the cash system of accounting.

(i) Gross receipts

As per section 89 of the DTC, the gross receipt shall be the aggregate of the following :

- (a) the amount of voluntary contributions received;
- (b) any rent received in respect of a property consisting of any buildings or lands appurtenant thereto;
- (c) the amount of income derived from any business carried on by it, if,—
 - (i) the business is incidental to the permitted welfare activity so carried on; and
 - (ii) the permitted welfare activity so carried on does not involve any activity for the advancement of any other object of general public utility;
- (d) full value of the consideration received from the transfer of any investment asset, not being a financial asset;
- (e) full value of the consideration received from the transfer of any business capital asset, if,—
 - (i) the business is incidental to the permitted welfare activity carried on by it; and
 - (ii) the permitted welfare activity so carried on does not involve any activity for the advancement of any other object of general public utility;
- (f) the amount of any income received from any investment of its funds or assets; and
- (g) the amount of any incoming, realization, proceed, donation or subscription, received from any source.

The gross receipts shall, not however, include any loan, borrowings and advances during the financial year.

(ii) Outgoings

The outgoings shall be the aggregate of the following—

- (a) voluntary contributions received during the financial year made with a specific direction that they shall form part of its corpus;
- (b) the amount actually paid during the financial year for any expenditure, not being a capital expenditure, incurred wholly and exclusively for earning or obtaining any receipts in respect of which the provisions of this chapter not applies;
- (c) the amount actually paid during the financial year for any expenditure, not being a capital expenditure, incurred for the purposes of carrying out the permitted welfare activity;

- (d) the amount actually paid during the financial year for any capital expenditure for the purposes of any business, if the business is incidental to the permitted welfare activity carried on by it; and the permitted welfare activity so carried on does not involve any activity for the advancement of any other object of general public utility;
- (e) the amount actually paid during the financial year for any capital expenditure in relation to any investment asset, not being a financial asset;
- (f) any amount, other than non-profit organisation engaged in similar permitted welfare activity; and
- (g) any amount applied outside India during the financial year, if,—
 - (i) the amount is applied for an activity which tends to promote international welfare in which India is interested; and
 - (ii) the non-profit organisation is notified by the Central Government in this behalf.

5. No accumulation permitted under new law

Under the present Income Tax Act, section 11(1)(a) and 11(2) provide for accumulation of income by the charitable trust. Under the provisions of section 11(1)(a), income from property held under trust for religious or charitable purposes is exempt to the extent it is applied for such purposes. In addition to the income spent on charitable or religious purposes during the relevant accounting period, income accumulated or set apart for application to such purposes up to 15 per cent of the income is also exempt. Thus, where a trust spends 85 per cent of its income during the year on its objects, it will be entitled to exemption in respect of its entire income by accumulating the remaining 15 per cent of its income.

It is likely that the charitable trust, for reasons beyond its control cannot utilise its income wholly or partially, or wants to accumulate its income for some project or scheme. It can then obtain exemption under section 11(2) by accumulating the income for future application subject to the conditions prescribed thereunder.

Thus the total 100 per cent of income can be accumulated under the present law and it will qualify for exemption—15 per cent under section 11(1)(a) and 85 per cent under section 11(2) which is a specific provision for setting apart.

Under the DTC, there is no provision for accumulation. Under the new code the gross receipts of the charitable trusts will be reduced by the outgoings as mentioned above and the balance of the receipt will be treated as total income of the trust chargeable to tax at the rate of 15 per cent. In the outgoings nothing is mentioned about the income which could not be spent in the current financial year but is likely to be spent for charitable purposes in next year or at any time in future. There is no provision for set off of any excess expenditure of current year in the subsequent year and similarly there is no provision to deem any receipt as outgoing if the same could not be spent during the current financial year. Thus if a trust receives donation in the last days of the financial year and could not spend the same due to lack of time gap, the same will be treated as income of the trust liable to tax. This would be a very anomalous situation likely to be faced by the NPOs under the new law.

It is however true that non receipt of income would now not be a reason for not incurring expenditure because the receipts and outgoings will be considered in accordance with cash system of accounting.

6. Suggestions for the new code

(i) Provision for treatment of loss to be provided

Chapter III of the Direct Tax Code provides for computation of total income. This chapter provides computation in respect of income from special sources and income from ordinary sources. The special and ordinary sources do not cover income of NPO's. Further section 87 of the new code specifically

provides that the total income of any non-profit organisation shall be computed in accordance with the provisions of Chapter IV. Though sections 58 and 59 of the code provide for setting off of unabsorbed losses but such type of provision is not there in Chapter IV. If similar adjustment or rule of aggregation is provided in Chapter IV also then the position will be as under.

The following illustration may clarify the impact of this suggestion—

<i>Particulars</i>	<i>Fin yr. 2011-12</i>	<i>Fin yr. 2012-13</i>	<i>Fin yr. 2013-14</i>
Gross Receipt	5,00,000	3,00,000	2,00,000
Outgoings	4,00,000	4,00,000	1,50,000
Unabsorbed preceding years loss	-	-	1,00,000
Total Income	1,00,000	Nil	Nil
Unabsorbed loss	-	1,00,000	50,000

(ii) Accumulation to be permitted under new code

The Direct Tax Code provides for taxation of the whole of the income of the trusts @ 15 percent and it does not provide for any exemption or deduction for accumulation of income. If the code is passed without any change in taxation of NPOs, it will be detrimental to the functioning of the organisations working for the interest of the society. Taking into consideration, the genuine problem likely to be faced by such organizations in spending of its receipts in current financial year, the provision for accumulation as it is existing under the present Act, should be provided.

(iii) Comment

If receipts cannot be spent during the current financial year and it is spent in the next financial year then there should be provision for adjustment of such expenditure in the next year. For this purpose either of the provision i.e. as explained in item 1 or as explained in item (ii) above can be adopted under the code. If the code is passed without any change, this nil certainly be very harsh for NPO's and can be challenged.

7. Business held under trust would no longer be exempt

Under the DTC it has been clearly provided under section 95 that if any person holds any business under trust then the provisions applicable to NPO shall not be applied regardless of any specific direction that the business shall form part of the corpus of such person; or the income from the business shall be applied only for permitted welfare activity.

Under the existing law where a business was settled in trust as property, the income earned therefrom, as held by the Supreme Court in *CIT v. Dharmodayam Co. (1977) 109 ITR 527 (SC)*, was exempt before the insertion of sub-section (4A) of section 11. However, after the insertion, even in such cases, the business income of the trust will be liable to tax under section 11(4A), unless it falls within the exceptions, i.e., it is incidental to the attainment of the objectives of the trust.

In *CIT v. Dharmodayan Co. (1998) 233 ITR 250 (Ker)*, it was held that in spite of the provisions contained in sub-section (4A) if the business itself was held in trust for charitable purpose then the trust would still be entitled to exemption under section 11(1) read with section 11(4) without having to fulfil the conditions of section 11(4A).

But the Supreme Court in *Asstt. CIT v. Thanthi Trust (2001) 247 ITR 785 (SC)*, held that the requirement that business should be incidental to the attainment of the objectives of the trust would apply to both businesses held under trust and business run by trust but not held as corpus. Consequently even in case where the business itself is held in trust it will have to fulfil the conditions mentioned in section 11(4A). Accordingly, the business would qualify for exemption only if the business is incidental to the attainment of the objectives of the trust and separate books of account are maintained by the trust in respect of such business.

Under the new code no concessional treatment will be provided in respect of business held in trust even if its income is applied only for permitted welfare activities. Under the new code concessional treatment will be provided only where any person actually carries on any business which is incidental to the permitted welfare activities carried on by it.

8. Registration requirement under new code

In order to obtain concessional tax treatment under the new code, registration with the Chief Commissioner or Commissioner is necessary. It is not however provided as to whether trust already registered under section 12AA under the present Act would continue to be valid or it has to get registered again under new code. As there is substantial change in eligibility criteria for being treated as NPO, under the Direct Tax Code it appears that all the trusts should seek fresh registration order under new code.

9. Conclusion

The DTC intends to provide an altogether new tax regime for charitable trusts. The term charitable purpose has been renamed as permitted welfare activity. The various provisions dealing with exemption to charitable trusts have been simplified. As per DTC, the charitable trusts would be liable to tax at the rate of fifteen percent of their surplus as calculated in a prescribed manner and as per cash system of accounting. There is no provision for accumulation of income by the trusts under the new code.