Executive Summary

The Income Tax Act, 1961 (the Act) provides for tax exemptions to various entities, including Government funded entities, engaged in objects which are charitable in nature, in order to encourage and fulfil social objectives, in areas such as charity, religion, medical, education etc. These entities receive donations, voluntary contributions and have other incomes from activities which are charitable in nature. The receipts of such entities are required to be applied for the objects for which these Trusts and Institutions have been set up. The Income Tax Department (ITD) has the responsibility of ensuring that incomes of genuine and eligible Trusts and Institutions only are exempted from levy of income tax and that they pay the correct amount of tax.

Audit conducted a Performance Audit on Exemptions granted by the Income Tax Department to Charitable Trusts and Institutions, with the objectives of examining:

i. whether the CBDT ensures in an effective manner that the Charitable Trusts and Institutions, which are availing the benefits under Sections 10(23C), 11, 12, 13, 80G(5) of the Income Tax Act, complied with the prescribed procedures regarding registration/approval and ensures monitoring thereafter;

ii. whether the ITD is efficient in granting the exemptions to the Charitable Trusts and Institutions under the above provisions of the Act and such exemptions are given to the eligible entities accurately and in a timely manner; and

iii. whether the existing provisions in the Act/Rules/CBDT Instructions relating to Assessments of the Charitable Trusts/Institutions are sufficient or are there any lacuna/ambiguity/inconsistency.

The Performance Audit covered the assessment of the charitable or religious Trusts or Institutions relating to the AYs 2014-15 to 2017-18. The Pr. DGIT(Systems) provided assessee-wise data containing 6,89,011 cases, pertaining to ITRs processed /assessed/rectified during FY 2014-15 to FY 2018-19 with respect to Charitable Trusts and Institutions. The data received from the Pr. DGIT (Systems) was analysed and based on audit parameters a sample of 6,390 cases was drawn as audit universe for scrutiny by different field offices under our audit jurisdiction. However, due to the prevailing situation, arising out of the Covid-19 pandemic, the audit sample was reduced to 5,798 cases. Further, in respect of any assessee whose assessment for a particular Assessment Year was selected in the audit sample and where Audit found a deficiency or non-compliance, Audit selected all remaining assessments also between AYs 2014-15 to 2017-18 for this Performance Audit. Accordingly, 1,028 additional assessment cases were selected for this Audit.

Apart from the above audit sample, in order to examine summary cases, 200 high value summary cases in respect of PANs which were not part of the original sample including additional cases, were also selected for audit. Thus, the total audit sample for the PA was 7,026 cases, out of which the Department produced records of 6,260 cases and 766 cases were not produced to Audit.

An Entry Conference was held with the ITD/CBDT on 23rd December 2019. Field audit was conducted during January to March 2020 and September to October 2020. Supplementary field audit including the top 200 assessees, the top 200 summary cases and a follow-up field audit verification of cases highlighted in the Report No. 9 of 2019 (Direct Taxes) continued till January 2022. An Exit Conference on the Performance Audit was held with the CBDT on 4th March 2022.

During this Performance Audit, Audit checked 6,260 assessment records and noticed 1,580 errors, related to various systemic and compliance issues having tax effect of ₹ 1,983.34 crore.

Further, Audit also reviewed the action taken by the ITD through its Action Taken Note (ATN) relating to earlier PA findings in Report No. 20 of 2013 and Chapter VI of the Compliance Audit Report No. 9 of 2019 (Direct Taxes) and the recommendations of the Public Accounts Committee (PAC).

A summary of the main audit findings is given below:

- Audit noticed that certain irregularities relating to internal audit of the registration process, ineffective monitoring of accumulation of income and its utilization, ineffective monitoring of receipts and utilization of foreign contribution, the inadequacy of survey of educational Trusts, absence of provision for disclosure of TDS in the audit report, etc. which were highlighted in the earlier Performance Audit Report No. 20 of 2013 and some of the specific recommendations of the Public Accounts Committee (PAC) against such irregularities were not satisfactorily addressed by the ITD.

  (Paragraph 3.2)

- Audit noticed an increasing trend in number of Trusts/Institutions claiming exemptions from AYs 2014-15 to 2016-17; however, the number of Trusts/Institutions claiming exemptions for AY 2017-18 slightly decreased.

  (Paragraph 4.1.1)

- Analysis of data of 6.89 lakh cases pertaining to ITRs for AY 2014-15 to AY 2017-18 revealed that the ITD scrutinized only 0.25 lakh (3.7 *per cent)* of the total cases while 6.30 lakh (91.4 *per cent*) cases were processed under summary manner in an automated environment. However, Audit noted certain deficiencies in the ITD system which led to incorrect claims of exemption along with the possibility of revenue leakage such as:

- Due to wrong input of data required for selection criteria in CASS, several cases were incorrectly selected for scrutiny by the ITD system.
- There is an absence of adequate checks and validations to match the registrations/approvals data provided in the ITR Form-7 with the ITD systems database before allowing exemptions in case the returns were processed in summary manner. In 42 assessment cases, exemption was allowed although assessees did not mention their registration details under Section 12A/10(23C) of the Act in the ITR Form-7. In 10 assessment cases, the assessees claimed exemptions for years together prior to its registration or having no registration under the Act, and the same was allowed by the Department in the summary assessment.
- Analysis of data of 6.89 lakh cases provided by the Pr.DGIT (Systems) revealed that exemption was allowed in 0.21 lakh cases although registration under Section 12AA was not available. In case of foreign contribution, Audit noticed that in 347 cases, foreign contribution was received by the assessee though the registration details under FCRA were not available. Thus, field validations in the above related field were not available in the ITR Form-7.

(Paragraph 4.1.3, 5.3.1, 5.3.2, 5.3.4.1 and 5.3.4.2)

- Out of 6.89 lakh cases processed/assessed/ rectified by the ITD during the FY 2014-15 to FY 2018-19, in 5.12 lakh cases (74.3 *per cent*) the income returned was ₹ zero.

(Paragraph 4.1.6)

- Analysis of 580 high value exemption cases (having gross income of ₹ 50 crore or above) revealed that 186 cases, which pertained to government entities, were granted 50.8 *per cent* of total exemptions (₹ 1.31 lakh crore) whereas the remaining 394 cases, which pertained to private entities, were granted 49.2 *per cent* of total exemptions.

(Paragraph 4.3.6.2)

- An analysis of data of the top 200 audit sampled cases (involving 169 Trusts/Institutions) where gross income for each case was ₹ 167.9 crore or above, revealed that out of the 169 Trusts/Institutions, 101 Trusts/ Institutions were Government entities while 66 were private entities (records of two entities were not produced to audit). Activity-wise analysis of data revealed that in case of Government entities, the top 30 entities (29 *per cent*) were engaged in other activities (like pension and gratuity fund, welfare board etc.) whereas in case of the top private entities, 28 entities (42 *per cent*) were engaged in educational activities.

(Paragraph 4.3.8.1)

- Audit observed that there is no clarity on allowing deduction under Section 80G for donations out of CSR fund. As a significant amount is spent by the companies toward CSR activities through the Trusts claiming exemptions under Section 80G, it requires urgent attention of the Department to bring clarity to the issue to ensure that the provisions are interpreted uniformly by the AOs and to minimise the possibility of litigation.

(Paragraph 5.1.2.3)

- The IT Act has no clarity regarding allowance of various expenses under the head "administrative and establishment expenses" for the purpose of determining application of income. Since administrative and establishment expenses could be of various categories, some part of which may be directly attributable for generation of income while some part may be towards charitable and religious purpose, the ITD needs to bring more clarity in the Act for this purpose.

(Paragraph 5.1.2.6)

- 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)

- There was no parameter to verify the identity of the donors for detection of anonymous donation. Audit noticed six assessment cases where the department did not verify genuineness of the donors and therefore, did not tax the anonymous donation(s) as per provisions of the Act. The Ministry has since addressed this issue through the Finance Act 2020.

(Paragraph 5.1.2.10)

- The ITD did not produce registration/approval records of 194 cases (*45 per cent*) out of 425 cases registered/approved for exemptions during the FY 2014-15 to 2018-19. Further, Audit noticed deficiencies in following the prescribed procedure(s) relating to registration/approval such as delay in grant of registration/approval, irregular grant of registration, grant of registration/approval without submission of prescribed documents, grant of registration without verification etc.

(Paragraph 5.2.1, 5.2.2, 5.2.3, 5.2.4 and 5.2.5)

- Audit noticed deficiencies in the Audit Report in Form 10B applicable to charitable Trusts/Institutions such as absence of details of break-up of receipt under different heads, details of corpus donation, deemed application of income etc. which impacted the quality of assessment, incorrect claim made by the assessee and loss of revenue.

(Paragraph 5.3.6)

- Audit observed that the ITD allowed accumulation in 66 assessment cases in contravention to the provisions stipulated under Section 11(2) of the Act.

(Paragraph 6.3)

- Audit noticed 22 assessment cases where the assessees utilised their income or property for the benefit of persons specified under Section 13(3) (i.e., related parties), but the ITD did not levy tax on such amount of income or property utilised for the benefit of the specified persons.

(Paragraph 6.4)

- Audit observed non-compliance of various provisions of the Income Tax Act in the assessment orders, which culminated in irregular allowance of double benefits to the assessees. In eight assessment cases, depreciation on assets was allowed as application of income, even though the relevant capital expenditure to acquire such assets had already been treated as application of income. In 11 assessment cases, the AO had allowed claims, pertaining to application of income incurred from the corpus fund, or other specific purpose funds.

(Paragraph 6.5.1 and 6.5.2)

- In 65 assessment cases, the AO while finalizing the assessment adopted incorrect figures, computed short demand, charged tax at a lower rate than the prescribed rate, levied interest/surcharge incorrectly, or granted excess interest on refund etc.

(Paragraph 6.8)

- The ITD has not allocated specific codes to different charitable activities linked with Section 11 and sub-Sections of 10(23C) under which exemption is being claimed. Further, the data relating to exemption claimed by the Government/Private Trust under different Sections were not being captured in ITR Form 7. The ITD needs to ensure activity wise monitoring of these private charitable entities, to mitigate the risk of ineligible claims.

(Paragraph 7.1.1)

- Although the PAC in its 104th Report (16th Lok Sabha) had recommended that the process of registration/approval of the Charitable Trusts/Institutions should be brought under the purview of Internal Audit of the ITD, it was not until FY 2019-20 that the Internal Audit commenced in respect of the registration applications processed. Moreover, Audit noticed that the instructions issued with regard to Internal Audit of registration process was not uniformly implemented in all the states. Audit further noted that the circular issued by the ITD regarding Internal Audit is applicable to registration granted under Section 12AA only but does not cover cases approved under Section 10(23C) and 80G(5).

(Paragraph 7.1.3 and 7.1.4)

- Audit noticed that very few surveys were conducted by the Department in comparison to the number of assessees claiming exemption under the Act to monitor the activities of the Trusts/Institutions. Further, in spite of specific recommendation of the PAC that survey of all educational trusts be conducted in a time-bound manner, Audit observed that the ITD conducted surveys of only 0.3 *per cent* of the total 2,686 educational trusts (2,105 assessees) included in the audit sample during 2014-15 to 2018-19. Further, no survey was conducted in respect of 46 high value educational trusts (having receipt of ₹ 200 crore or more) during the aforesaid period.

(Paragraph 7.1.5)

- There was inconsistency in allowing exemption to Trusts/Institutions having activities not charitable in nature. Audit observed in 10 assessment cases where the AO assessed that the activities of the Trusts were not charitable in nature for one or more AYs but took no action to review exemptions for the other AYs although the objects of the trust were similar during the respective AYs which resulted in irregular grant of exemptions.

(Paragraph 7.1.6)

- Audit observed in eight cases that the status of the Trusts/Institutions was not reviewed by the competent authority as per provisions of Section 12AA(3) and 12AA(4), although the AO had denied the exemption under Section 11 of the Act for either holding that the activities of trusts were not genuine or the properties or income of the trusts were continuously utilised by the trust for the benefit of related persons.

(Paragraph 7.1.7)

- Audit noticed that due to lack of monitoring of the activities of Trusts/ Institutions engaged in scientific research, there were bogus claims of exemption by the trusts as well as issue of bogus certificates under Section 35(1)(ii) to the donors.

(Paragraph 7.1.9)

- Audit noticed deficiencies of the ITD in effective monitoring of accumulation and its utilizations by Trusts/Institutions in the manner laid down in the Act. In 32 assessment cases, the Department did not effectively monitor utilization of past accumulated income as provided in Section 11(2). Further, there is no provision in the Act for declaration of the purpose/period of accumulation under Section 10(23C).

(Paragraph 7.1.11 and 7.1.12)

- Audit observed that the ITD has no mechanism to verify receipt and utilization of foreign contribution shown in the ITR Form-7 and that disclosed with Ministry of Home Affairs (MHA) under the FCRA Act. Although the PAC had made specific recommendation that the ITD should formulate a data sharing mechanism with the MHA to keep a track of foreign contribution received and its application, the ITD has yet to take any action on the issue. The deficiency resulted in incorrect claim of exemption on foreign contribution in 35 cases.

(Paragraph 7.1.13)