Chapter 1: Introduction

1.1 Introduction

Charitable organisations/institutions have played a significant role in sharing government responsibility towards providing various services to the underprivileged people, development and welfare of the country through various charitable activities and running non-profitable organisation/ institutions. Such organisations mainly depend upon donations, grants, fees etc. received from corporate houses, governments, voluntary contributions and foreign contributions etc. These organisations/institutions are to be registered under various enactments *viz.* Societies Registration Act, 1860; the Religious Endowments Act of 1863; the Indian Trusts Act of 1882; and the Charitable Endowments Act of 1890 etc. to obtain legal status and protect their interests and assets. Apart from voluntary organisations/institutions, some corporate houses and other entities also form companies under Section 25 of the Companies Act[1] for the purpose of promoting commerce, art, charity and religion etc. These companies are formed for philanthropic purposes only, and the payment of dividend is prohibited.

The Indian Constitution also guarantees a distinct legal space to such institutions through Article 19(1)(c) of the Constitution, relating to the right to form associations or unions. Charity and Charitable organizations are included in the Concurrent List or List-III (Seventh Schedule), Item 28, of the Constitution of India, which means that both the Central and the State Governments are competent to legislate on this subject.

Apart from the above legislations, the Income Tax Act 1961 is also applicable to charitable institutions, while in the case of foreign contributions received by these charitable institutions, the Foreign Contribution (Regulation) Act, 2010 will be applicable.

The Income Tax had been introduced in 1860, and in 1922, and 50 *per cent* tax exemption was granted to individuals on donations for charitable purposes. The Income Tax Act, 1961 (the Act) further broadened the definition of charitable purposes. Section 2(15) of the Act defines the expression “charitable purpose”. 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 education, medical, relief of the poor, religion etc. subject to compliance of certain provisions enshrined in Section 10(23C), Section 11, Section 12, Section 13 etc. of the Act. These

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[1] Section 25 has the provision for charitable and other companies under the Companies Act, 1956. Section 8 is the corresponding provision under the Companies Act, 2013.

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 are exempted from levy of income tax, and that they pay the correct amount of tax.

1.2 Legal Framework

1.2.1 Legal provisions relating to the Assessment Process for Income Tax Returns (ITRs) in the Income Tax Department are given in **Appendix 1.1**.

1.2.2 The specific provisions of the Act, relating to registration/approval/ notification, assessment of the Charitable Trusts/Institutions and exemptions to Charitable Trusts/Institutions under Sections 10(23C)(iiiab) to (via), 11 and 12 are discussed in the succeeding paragraphs. **It is clarified that the phrases "Charitable" and "Not for profit" are not identical. The medical/educational institutions existing solely for philanthropic purposes and not for the purposes of profit are covered under Sections 10(23C)(iiiab) to (iiiae); and 10(23C)(vi) and (via).**

1.2.2.1 Definition of 'Charitable Purpose' under Section 2(15)

Section 2(15) of the Act provides a definition of 'charitable purpose' which includes (i) relief of the poor (ii) education (iii) yoga (iv) medical relief (v) preservation of environment (including watersheds, forests and wildlife) (vii) preservation of monuments or places or objects of artistic or historic interest and (viii) the advancement of any other object of general public utility. The Section further provides that advancement of any other object of general public utility shall not be a charitable purpose, 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 or fee or any other consideration, irrespective of the nature of use or application, or retention of the income from such activity and the aggregate receipts from such activity or activities during the previous year, exceed ₹ 25 lakh (20 *per cent* with effect from 01.04.2016 of the total receipts) from such activity or activities. Further, an entity with such activity will be treated as 'non-exempt' entity for the relevant previous year, as per Section 13(8).

1.2.2.2 Provisions relating to Charitable Trusts/Institutions covered under Sections 11 and 12

(a) Grant of exemptions under Section 11 and 12

Section 11(1) of the Act deals with exemption available to all charitable and religious organisations for income derived from property held for charitable or religious purposes to the extent such income is applied for charitable or religious purpose 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 15 *per cent* of the income from such property.

Section 11(2) provides that if in the previous year, income applied to charitable or religious purposes in India falls short of 85 *per cent* of the income derived during that year, the trust can opt for accumulation of the not applied portion of the income, to be spent for specified purpose(s) in the next five years. Such accumulation is required to be furnished to the Assessing officer in Form 10[2] before the due date[3] prescribed in Section 139(1)[4] for furnishing the return of income.

Section 11(5) provides that the accumulated funds shall be invested in the specified modes such as saving certificates issued under the small saving schemes, deposit in the post office, scheduled bank, units of the Unit Trust of India, deposits in public sector companies etc.

Further, Section 12 provides for exemption of income of trusts or institutions from contributions which shall, for the purposes of Section 11, deemed to be income derived from the property held under trust wholly for charitable or religious purposes and provisions of Section 11 and Section 13 shall apply accordingly.

Thus, to summarise, under Section 11, there is no requirement for institutions existing solely for philanthropic purpose or not for profit, but only a restriction that accumulation of income cannot exceed 15 *per cent.*

The conditions for applicability of Section 11 and 12, given in Section 12A, are summarised as under:

(i) Charitable Trusts/Institutions are required to make an application in Form 10A in the prescribed manner to the Pr. CIT/CIT before 1st day of July 1973 or before the expiry of one year from the date of its creation or the establishment of the Institution whichever is later, for registration under Section 12AA.

(ii) Where the total income of a trust or institution as computed without giving effect to the provision of Section 11 and 12 exceeds the maximum amount which is not chargeable to Income Tax in any previous year, the accounts of the

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2 Statement to be furnished to the Assessing officer under Section 11(2) of the Act.

3 The due dates for filing of ITR for the AYs 2014-15, 2015-16, 2016-17 and 2017-18 were 30 September 2014, 30 September 2015, 17 October 2016 and 07 November 2017 respectively.

4 Section 139(1) of the Act provides that a person other than a company if his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income tax shall, on or before the due date, furnish a return of income.

trust or institution for that year are to be audited by a Chartered Accountant, and the Audit report in Form 10B is required to be filed before the due date.

(iii) With effect from 01.04.2018, entities in receipt of income have to furnish the return of income for the previous year in accordance with the provisions of Section 139(4A), within the time allowed under Section 139(1).

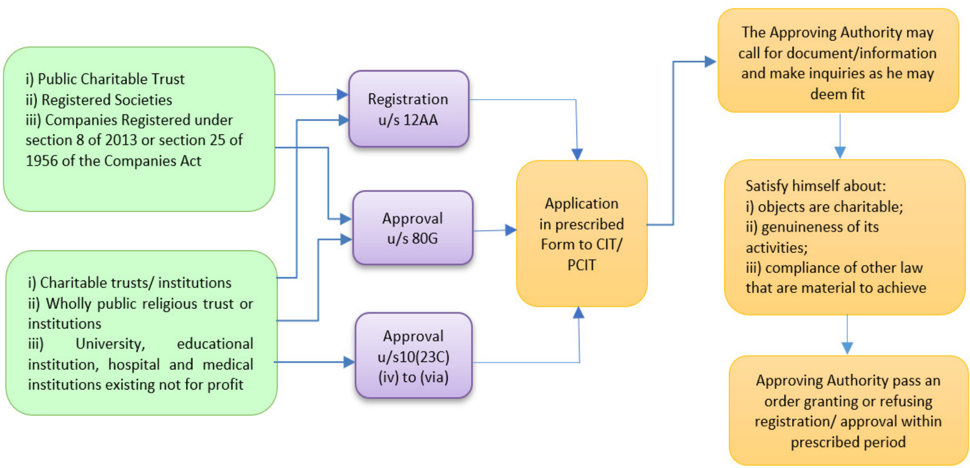
(b) Registration of Trust/Institution

Section 12AA of the Act provides that the Pr. CIT/CIT, on receipt of application for registration of a Trust/Institution, shall call for such documents or information as he thinks necessary and may also make such inquiries as he may deem necessary, in order to satisfy himself about the genuineness of activities of the organization. After satisfying himself about the objects of the trust or institution and the genuineness of its activities, he shall pass an order in writing registering the trust or institution.

The Section further provides that if the activities of Trust/Institution are not genuine or are not being carried out in accordance with the objects of the Trust/Institution or the activities are being carried out in a manner that the provisions of Sections 11 and 12 of the Act do not apply to exclude either whole or any part of the income of such Trust/Institution, Pr. CIT/CIT may, by an order in writing, cancel the registration of such trust or institution.

The procedure to be followed by the Department while granting registration/approval to entities for availing the benefit of exemption under different provisions of the Act is shown in the flow Chart 1.1 below.

Chart 1.1: Registration/Approval procedure



There is no bar on any Trust/Institution from getting registered under Section 12AA and approval under Section 10(23C), whose activities are charitable or religious in nature. Further, registration/approval, once granted, was perpetual prior to 1 June 2020[5], and could be cancelled only when the approving authority was satisfied that the activities of the Trusts/Institutions were not genuine or not being carried out in accordance with its objects. Once the objects of the Trusts/Institutions are established as charitable or religious, income of these entities from the property held by it shall be eligible for exemption, under different provisions of the Act.

(c) Circumstances under which the benefit of exemption would not be available under Section 11

Section 13 of the Act specifies the circumstances under which the benefit under Section 11 would not be available to an organization - (i) if the income is not applied for the benefit of the public; (ii) if the income is applied for the benefit of any particular religious community or caste; (iii) if the income or property is applied/used for the benefit of the specified person such as the founders, trustee, manager, chief functionary, major donors, and relatives of the founders or persons who have a substantial interest in the organization; and (iv) if the funds are invested in modes other than those specified in Section 11(5).

1.2.2.3 Provisions relating to special entities covered under Section 10(23C)

Apart from the Charitable Trusts/Institutions mentioned in para 1.2.2.2 above, there are certain educational, medical and religious institutions which are exempt under Section 10(23C) subject to fulfilment of certain conditions. The provisions of the Act relating to such special organizations are discussed in succeeding paragraphs:

(a) Organization funded by Government

University/Educational institutions and Hospital/Medical institutions, existing solely for educational/philanthropic purposes and not for the purposes of profit which are wholly or substantially[6] financed by the Government, are exempt from tax under Section 10(23C)(iiiab) and 10(23C)(iiiac) respectively. Such organizations are not required to obtain approval from Pr. CIT/CIT for availing of exemption. Filing of Income Tax Return is mandatory[7] for such organisations from AY 2016-17 onwards for claim of exemption. During the PA, Audit noticed that Government institutions like Indian Institute of Science Education and Research (IISER), Mohali, National Institute of Technology (NIT), Durgapur, Indian Institute of Management (IIM)[8], Bengaluru etc. have claimed exemption under Section 10(23C)(iiiab) and Sanjay Gandhi Postgraduate Institute of

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[5] Re-registration and re-approval process was inserted under Section 12AB and Section 10(23C) respectively by the Finance Act 2020 with effect from 1 June 2020.

[6] Rule 2BBB of the IT Rules provides that an entity, shall be considered as being substantially financed by the Government, if the Government grant exceeds 50 *per cent* of the total receipts including any voluntary contributions of such entity, during the relevant previous year.

[7] Inserted with effect from 1.4.2016 (Finance Act, 2015)

[8] IIM claimed exemptions in AY 2014-15 under Section 10(23C)(iiiab) and in subsequent AYs under Section 11.

Medical Sciences, Lucknow, Hassan Institute Of Medical Sciences, Hassan, Karnataka etc. have claimed exemption under Section 10(23C)(iiiac) of the Act.

(b) Organization having annual receipt not exceeding ₹ one crore

University/Educational institutions and Hospital/Medical institutions, existing solely for educational/philanthropic purposes and not for the purposes of profit, are exempt from tax under Section 10(23C)(iiiad) and 10(23C)(iiiae) of the Act respectively, if the annual income does not exceeds ₹ one crore. Such organizations are not required to obtain approval from Pr. CIT/CIT for availing of exemption. Filing of Income Tax Return is mandatory for such organisations for claim of exemption.

(c) Other specified organizations

The provisions of Section 10(23C)(iv) to 10(23C)(via) deal with other educational, medical institutions, funds and charitable and religious institutions which are exempt subject to fulfilment of certain conditions. Such specified organizations are:

(i) Section 10(23C)(iv): Any fund or institution established for charitable purposes which may be approved by the prescribed authority, having importance throughout India or any State or States can claim exemption under this Section. During the Performance Audit, Audit noticed that funds/ institutions like Punjab Building and Other Construction Workers Welfare Board, West Bengal State Health & Family Welfare Samity etc. have claimed exemption under this Section.

(ii) Section 10(23C)(v): Any trust or institution wholly for public religious purpose or public religious and charitable purpose is eligible to claim exemption and which may be approved by the prescribed authority. During the Performance Audit, Audit noticed that institutions like Ramkrishna Math, Shree Siddhivinayak Ganpati Temple Trust, Mumbai, The Assembly of God Church etc. have claimed exemption under this Section.

(iii) Section 10(23C)(vi): University or educational institution existing solely for educational purpose and not for the purposes of profit other than those mentioned in sub-clause (iiiab) or (iiiad) and which may be approved by the prescribed authority can claim exemption under this Section. During the Performance Audit, Audit noticed that institutions like MP Birla Institute of Management, Kolkata, Delhi Public School, Bhubaneswar, National Law Institute University, Gwalior etc. have claimed exemption under this Section.

(iv) Section 10(23C)(via): Hospital or medical institution existing solely for philanthropic purpose and not for the purposes of profit and which may be approved by the prescribed authority. During the Performance Audit, Audit noticed that institutions like Indian Red Cross Society, Mumbai, The Gujarat Research & Medical Institute, Ahmedabad etc. have claimed exemption under this Section.

The conditions for grant of exemption to the organizations mentioned in Sections 10(23C)(vi) to 10(23C)(via) are:

(a) Such organizations are required to apply in Form No. 56D to the Pr. CIT/CIT for grant of approval in order to claim of exemption.

(b) The Pr. CIT/CIT, on receipt of application, shall call for such documents or information as he thinks necessary and may also make such inquiries as he may deem necessary, in order to satisfy himself about the genuineness of activities of the organization. After satisfying himself about the objects and the genuineness of its activities, he shall pass an order in writing within 12 months granting approval to the institution or fund.

(c) The income of such organizations shall not be used for any private benefit.

(d) Filing of Income Tax Return in ITR-7 and the Audit report in Form 10BB are mandatory for claim of exemption.

(e) The exemption is available subject to the condition of 85 *per cent* application of income for its objects and it can opt for accumulation of the unapplied portion of the income, to be spent within a maximum period of five years.

(f) The accumulated funds have to be invested in the modes specified under Section 11(5).

1.2.2.4 Deduction in respect of donations to certain funds, charitable Trusts/Institutions etc.

The amount donated towards charitable Trusts/Institutions attracts deduction under Section 80G of the Act. Section 80G(5) contains pre-conditions which must be satisfied cumulatively, before the donation to the trust or institution becomes tax deductible in the hands of a donor. These conditions are summarized as under:

(i) The income of the Trusts/Institutions would not be includable in total income by virtue of provisions contained in Sections 11, 12 or Section 10(23C).

(ii) The income of the Trusts/Institutions is applied wholly for charitable purpose. Charitable purpose does not include religious purpose [Explanation 3 below Section 80G]. However, Section 80G(5B) permits application up to five *per cent* of the income of a year towards religious purposes in cases the Trusts/Institutions engaged in religious activities.

(iii) The Trusts/Institutions are not for the benefit of any particular religious community or caste;

(iv) The Trusts/Institutions maintain regular books of account regarding its receipts and expenditure; and

(v) The Trusts/Institutions are approved by the Pr. CIT/CIT in this behalf.