

# 6 CHARITABLE TRUSTS AND INSTITUTIONS: AN INSIGHT FROM INCOME TAX POINT OF VIEW

## Abstract

CHARITY has emerged as a major platform and is playing a decent role in improving the lot of the under privileged including needy persons. Generally in every city there are very few government schools and hospitals for proper service to the community as against the required number. To meet the requirements either the corporate sector or the individuals are coming up with number of charitable institutions for the service of the mankind. But these institutions are not properly abiding by the rule and the procedures of income tax provisions. This paper gives an insight into the legal provisions related to the same issue so that the institutions can take the best advantage of the same and benefit the society in a more comprehensive manner.

**Key words:** Charitable Institutions, Charity, Income Tax Provisions, Valid Trust, Public character, Not for Profit.

## Introduction – Basics

It is the duty of the state i.e. Central Government and State Government to provide medical facilities and provide education to every section of the society at a cheaper/reasonable rates. However due to inadequate financial resources with the Governments, and out of which major part is spent on heavy administrative/establishment expenses with the result that Central Government and State Governments have not been able to carry out the same effectively. Hence, the CHARITY has emerged as a major platform and is playing a decent role in improving the lot of the under privileged including needy persons. For instance in Ludhiana city in Punjab there are only two Government Colleges, whereas there are more than ten private colleges run by

N.G.O. (Trusts/Societies etc.). Likewise there is only one major Government Hospital i.e. Civil Hospital, Ludhiana, as against many big Hospitals run by charitable Societies/Trusts, Such as D.M.C., C.M.C. Guru Teg Bahadur Hospital, Mohandevi Oswal Cancer Hospital, Pahwa Hospital etc. etc., All these educational/medical institutions are not only serving the major section of Society, besides these have created huge employment opportunities both for professionals and others. For instance D.M.C. and C.M.C. two major hospitals alone have employees strength nearing to 2500 each. In addition to heavy TDS, Service Tax and VAT are being deposited/paid by these institutions.

## Objective of the Paper

This paper is an attempt to highlight the income tax provisions applicable to the charitable institutions.

It is a guide to understand the legal restrictions and the requirements for running a charitable institution for education, health services or any other purpose of public utility.

### **Charitable purpose**

Charitable purpose is defined in the Income Tax Act in a wide manner. Charity for tax purposes is not confined to relief of poverty. It is concerned with improving the quality of life all round and embraces all income classes. It may seek to promote health, welfare, happiness and culture. In this sense it is more philanthropy than charity. Word philanthropy appears in Sections 10(23C), (iii ac), (iii ae) and (vi a) of the Income Tax Act, 1961. The dictionary meaning of philanthropic is "desire to promote welfare of others".

The concept of charity under tax law is much wider than the common understanding of charity. Section 2(15) of the Income Tax Act, 1961 ('Act') defines "charitable purpose" to including the following:

- i. Relief of the poor
- ii. Education
- iii. Medical relief, and
- iv. The advancement of any other object of general public utility.

### **Exemption from tax to trust and legal obligation**

Section 11 of the Act, provides exemption from tax the income derived from property held under trust for charitable or religious purposes. Further according to Explanation 1 to Section 13 trust includes any other legal obligation. The various forms of legal obligation apart from the trust are as under:

- i. A society registered under the societies Registration Act, 1860,
- ii. A limited company registered under Section 25 of the companies Act, 1956,
- iii. A Hindu endowment,
- iv. A Muslim wakf

### **For creating a valid charitable trust four certainties must exist.**

- i. A declaration sufficient to show an intention to create a trust by the Settlor (The declaration must be binding on him.) written on appropriate Non judicial Stamp paper.
- ii. Setting apart definite property and Settlor depriving himself of the ownership
- iii. A statement of the object for which the property is thereafter to be held.
- iv. Beneficiary under the Trust.

It means that dedication of property to a charitable or religious trust [including Society registered under Societies Registration Act, 1860 etc.] is permanent. Even the fact that the trustees have failed to carry out the objects of the trust will not invalidate it and neither the founder nor his heirs can resume

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it. The founder/trustees can not alter the terms of the trust deed either. Strictly if the purpose of the trust becomes superfluous or illegal due to a change in law or social habits, the trustees are obliged to apply to the court for a cypres scheme providing for alternative charity.

### **Additional clauses for a valid trust**

In addition to usual clauses for creating a valid trust i.e. above stated four certainties, names of trustees including appointment of future trustees, operation of bank accounts etc. may be added. Income Tax department may ask for other information at the time of granting exemption u/s 10(23C) or u/s 12AA of the Income Tax Act.

- i. The benefit of the Trust/Society shall be open to all irrespective of caste, creed or religion.
- ii. The funds and the Income of the Trust/Society shall be solely utilized for the achievement of its objects and no portion of it shall be utilized for payment of the Trustees/Members by way of profits, interest and dividends etc.
- iii. The funds of the Trust/Society shall be invested in the modes specified under the provisions of section 11(5) of the Income Tax Act 1961 as amended from time to time.
- iv. There shall be maintained all accounts of the Trust/Society regularly. The accounts shall be duly audited by a chartered accountant. Every year the accounts shall be closed on 31st March.
- v. No amendment to the Trust Deed/Memorandum of Association/by laws/rules and regulations shall be made which may prove to be repugnant to the provisions of the sections 2(15), 10(23c), 11, 12 and 13 of the Income Tax Act, 1961 as amended from time to time. Further amendment if any as carried out shall be intimated to the concerned commissioner of Income Tax.
- vi. In the event of dissolution or winding up of the Trust/Society, the assets remaining as on the date of dissolution shall under no circumstances be distributed among the Trustees/Members of the Managing Committee/Governing body but the same shall be transferred to another charitable Trust/Society whose objects are similar to those of this Trust/Society and which enjoy recognition under sections 10(23c) and or Section 11, 12 and 13 of the Income Tax Act, 1961 as amended from time to time.

### **Public Character**

To qualify as 'charitable', a purpose must have a 'public character'. It must aim to benefit the community or a section of it, and not particular private individuals or identifiable groups. This test should be rigorously applied to exclude private trusts from benefiting from the exemption. However, it should be borne in mind that every object of general utility to the community is not necessarily charitable.

A trust established for the benefit of the employees of a company, even as big public sector company as the ITI, does not satisfy the conditions of Section 2(15). If the relevant rules indicate that the benefit of the scheme or the alleged charitable purpose can be utilized only by specified persons

who are required to be the subscribers or their dependents, there is no charitable purpose. See CIT v.BEL Employees Death Relief Fund (1997) 225 ITR 270 and CIT v.ITI Employees Death etc. Fund (1998) 234 ITR 308 (both Kar).

However, it was seen that a number of entities who are engaged in commercial activities were also claiming exemption on the ground that such activities were for the advancement of objects of general public utility in terms of the fourth limb of the definition of 'charitable purpose'. Therefore, section 2(15) was amended vide Finance Act, 2008 by adding a proviso which states that the 'advancement of any other objects of general utility' shall not be a charitable purpose if it involves the carrying on of -

- a. Any activity in the nature of trade, commerce or business; or
- b. Any activity of rendering any service in relation to any trade, commerce business; for a cess or fee or any other consideration, irrespective of the nature of use of application, or retention of the income from such activity.

### 1. Implication from the amendment-

The newly proviso to section 2(15) will not apply in respect of the first three limbs of section 2(15), i.e. relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute 'charitable purpose' even if it incidentally involves the carrying on of commercial activities.

'Relief of the poor' encompasses (include comprehensively) a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated under section 11(4A) or the seventh proviso to section 10(23C) which are that

- i. The business be incidental to the attainment of the objectives of the entity, and
- ii. Separate books of account should be maintained in respect of such business.

Similarly, entities whose object is 'education' or 'medical relief' would also continue to be eligible for exemption as charitable institutions even if they incidentally carry on a commercial activity subject to the conditions mentioned above.

2. The newly inserted proviso to section 2(15) will apply only to entities whose purpose is 'advancement of any other object of general public utility'. Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

2.1 There are industry and trade associations who claim exemption from tax u/s 11 on the ground that their objects are for charitable purpose as these are covered under 'any other object of general public utility'. Under the principle of mutuality, if trading takes place between persons who

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are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants. Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutually. However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

2.2 In the final analysis, however, whether the assessee has for its object 'the advancement of any other object of general public utility' is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its objects is charitable purpose. In such a case, the object of 'general public utility' will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible. Assessee, who claim that their object is 'charitable purpose' within the meaning of Section 2(15), would be well advised to eschew (obtain from) any activity which is in the nature of trade, commerce or business or the rendering of any service in relation to any trade, commerce or business.

**In case reported at (2000) 246 ITR 731(Del) in the case of C.I.T. Vs. Kannada Education Society, it was held that condition precedent for availing of exemption for educational purposes under the Income Tax Act are as follows:**

- a. The educational institutions must actually exist and mere taking of steps would not be sufficient.
- b. The educational institution need not be affiliated to any university or board. In fact society need not itself be imparting education and it is enough if it runs some schools or colleges:
- c. The educational institutions must exist solely for educational purpose and not for purposes of profit. But merely because there is surplus, it cannot be said that the educational institution exists for profit.
- d. If an educational institution makes profit incidentally e.g. the publishing and selling text books, and such profit are to applied only for the spread of education, it is entitled to exemption.

**The exemption u/s 10(22) (now 10(23C))** is available to an educational institution existing solely for educational purpose and not for purposes of profit. **It is the income of the institution not only the income from the institution, which is exempt. The former is a wider concept.** This has been illustrated by the facts in *Brahmin Educational Society v. CIT* (1997) 227 ITR 317 (Ker.). The Society had organized chits, the business income from which was used for educational purposes. The court held that it is an institution existed solely for educational purposes. The Income derived by it from any of source would be covered by the exemption in Section 10(22). Further court directed to grant certificate

under Section 80G of the Income Tax to the petitioner for the assessment year required by it.

**The educational institution referred to in Section 10(22) {now 10(23C)}** need not have a separate legal existence, It can be a constituent of a trust, society or a company. It can be run even by an individual. Still if it answers the requirements of that section, it will qualify for exemption. See the decision of Madras High Court in Calavala Cunnan Chetty Charities (1982) 135 ITR 485 and also Board's Instruction no.1112 dated 9.7.1977. The court has held that in the case of a multipurpose (not merely educational) charitable trust running educational institutions and charities, the educational institutions will qualify for exemption u/s 10(22), if they have distinct identities and accounts. In fact the auditor should ensure that the educational funds are retained and used only for educational purposes.

Conversely, a society formed for the sole purpose of establishing, running, managing or assisting schools and colleges is itself an educational institution is entitled to exemption u/s 10(22). **Aditanar Educational Institution v. Addl. CIT (1997) 224 ITR 310 (SC)**. What is to be looked into in such cases is whether the sole purpose of the trust is education – not merely the stated purpose but the real purpose.

It has been further held that eligibility for the exemption is subject to departmental scrutiny year after year. This decision being the law of the land makes it obligatory for all educational institutions to submit their Income Tax returns. Hence the AO will be within his rights in asking the assessee to file its returns and subject itself to tax security. In fact in Action Plan all charitable institutions with gross receipts above Rs.10 crore are taken up for security assessments.

**The expression 'not for purposes of profit'** does not stipulate that the institution should provide education or medical relief at cost or below cost and should not make any surplus. The very scheme of the law contemplates surplus, as otherwise there will be no need for a provision like Section 10(23C) giving exemption to it. What is prohibited is only private gain from out of such surplus. As long as the surplus is ploughed back into the institution and utilized for its purposes, the exemption will be available. In its instruction No.1112 dated 9.7.1977 the Board has clarified that only 'if the profit of the educational institution can be diverted for the personal use of the proprietor thereof, the income will be subject to tax'.

**The university or education institution, hospital or medical institution which satisfies any one of the following two conditions is not required to apply for exemption for availing exemption u/s 10(23C)-**

- i. It is wholly or substantially financed by the Government. [Section 10(23C) (iiiab), (iiiic)]
- ii. Where total aggregate annual receipts does not exceed Rs.1 crore [Section 10(23C)(iiiad), (iiiie)].

**University or educational institution, hospital or medical institution is required to file return of income**

The finance Act, 2002 has inserted a section 139(4C) w.e.f. Asstt. Year 2003-04 which provides that every fund or institution referred to in sub-clause (iv) or trust or institution referred to in sub-clause (v) or any university or other educational institution referred to in [sub-clause (iiiad) or] sub-clause (vi) or any hospital or other medical institution referred to in [sub-clause (iiiie) or] sub-clause (via) of

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clause (23C) of section 10 are required to file return if the total income of such university or educational institution, hospital or medical institution is assessable, without giving effect to provision of section 10, exceeds the maximum amount which is not chargeable to tax. [It may be noted that university or institution, hospital or medical institution wholly or substantially financed by Government is not covered for this purpose].

Such university or educational institution, hospital or medical institution will furnish a return of income of the previous year presently in ITR VII verified in the prescribed manner and setting forth such other particulars as may be prescribed and all provisions of Income-Tax Act shall apply as if it were return required to be filed u/s 139(1). Needless to add this is manual return as per past and all the documents including TDS certificates in original are to be attached with the return.

**University or other educational institution, hospital or other medical institution is required to get its accounts audited and file the same with return of income**

The 10th proviso (Un numbered) to section 10(23C) inserted by the Taxation Laws (amendment) Act, 2006 provides that where the total income, of the 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 (vi a) without giving effect to the provisions of the said sub-clause exceeds the maximum amount which is not chargeable to tax in any previous year such trust or institution or any university or other educational institution or any hospital or any other medical institution shall get its account audited in respect of that year by a C.A. and furnish along with the return of income, the report of such audit in the prescribed form 10BB duly signed and verified.

**Conclusion**

The very purpose of a charitable institution is defeated if it is not able to comply with these provisions and give the best services to the community. If any organization intends to serve the cause of humanity and fulfill its social responsibility, it must take it seriously and try to follow all legal requirements so that it gets the full income tax benefit as well as give the best possible services to the community.