

OFFICE OF THE COMPTROLLER AND AUDITOR GENERAL OF INDIA

NEW DELHI

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**PERFORMANCE AUDIT ON EXEMPTIONS TO CHARITABLE TRUSTS AND INSTITUTIONS
TABLED**

The Comptroller & Auditor General of India (C&AG) carried out a Performance Audit (PA) on 'Exemptions to Charitable Trusts and Institutions'. This Audit Report No. 12 of 2022 on Direct Taxes was carried out from January to March 2020 and September to October 2020; and Supplementary audit and a follow-up audit continued till January 2022. Audit findings were discussed with the Central Board of Direct Taxes (CBDT) in March 2022. The Report was laid on the floor of the Parliament here today.

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.

One of the grounds for selecting this topic for Performance Audit was that the Public Accounts Committee (PAC), in its 104th Report, on the action taken by the Government on the observations/recommendations of the Committee contained in its 27th Report (16th Lok Sabha), had, *inter alia* expressed its concern over the serious nature of the violations and failure of the ITD to monitor whether the trusts were fulfilling the objectives under which they had been established. The Committee, in its report, also desired that the office of the Comptroller & Auditor General of India submit a report on the violations by Public Charitable trusts and make recommendations on how to remedy the gaps and prevent such recurrences in future.

The objectives for this Performance Audit were to examine 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; 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 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. 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 follow-up audit included in Chapter VI of the Compliance Audit Report No. 9 of 2019 (Direct Taxes) and the recommendations of the Public Accounts Committee (PAC).

Summary of 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)

- 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.

(Paragraph 5.3.1)

- 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 5.3.2, 5.3.4.1 and 5.3.4.2)

- 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 other trusts. 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 assessee 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 assessee. 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)

- 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 assessee 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 assessee) 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)

- 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)

Summary of Recommendations

Audit recommends that:

- *The ITD may consider granting registration to educational Trusts/ Institutions under Section 12AA on the condition that separate accounts have to be maintained for educational and non-educational activities and educational activities are to be dealt with as per the provisions of Section 10(23C). Further, the CBDT may consider the option of getting a separate ITR filed by the Assessee Trusts/ Institutions for educational activities and non-educational activities.*
(Paragraph 5.1.1)
- *The purpose of having two sets of overlapping Sections, especially with respect to educational and medical purposes, one under 'not for profit category' (which involves higher restrictions) under Section 10(23C) and another 'the charitable category' (with fewer restrictions) under Section 11 is not clear to Audit. Logically, most entities with a choice would not opt for the restriction, not for profit category. In general, the*

stipulations under various sub-Sections of Section 10(23C), requiring that institutions exist solely for philanthropic purposes and not for the purposes of profit, are more onerous than those under Section 11, which merely restrict accumulation of annual income beyond 15 per cent and have no specific “not for profit” purpose; however, the provisions for exemption of income under both categories are virtually identical.

Department of Revenue may consider reviewing these stipulations in the Act under various categories in the light of clear Governmental policy determination in terms of which charitable objectives merit exemption of income with a requirement of “solely philanthropic purposes and not for the purpose of profit” and which charitable objectives merit income exemption without such a requirement.

(Paragraph 5.1.1)

- *The ITD may issue a Standard Operating Procedure/instructions/ guidelines for examining the valuation aspects of transactions with related parties and devise a clear mechanism to justify the ‘reasonableness’ and ‘adequacy’ of the transactions held with the related party of the trust so that the Assessing Officer may satisfy himself as to the reasonableness and adequacy of the transactions during the Assessment proceedings; and levy tax on amount of Income or property utilized for the benefit of the related parties in excess of the amount assessed as reasonable and adequate.*

(Paragraph 5.1.2.1)

- *CBDT needs to consider bringing an amendment or issuing binding clarification as to whether donations to trusts, including in-house/corporate trusts, out of CSR expenditure by specified companies covered by Section 135 of the Companies Act, 2013 is eligible for deduction under section 80G or not. Such an amendment or binding clarification is necessary to ensure that the provisions are interpreted uniformly by the Assessing Officers across all assessment charges and also to minimize the possibility of litigation.*

(Paragraph 5.1.2.3)

- *The ITD may consider bringing in new provisions in the Act, so as to ensure that specific purpose donation, if not utilized for the specified purpose (like mere transferring such donation later on to other organizations etc.) should attract denial of exemptions and be treated as income in the year in which it is detected.*

(Paragraph 5.1.2.4)

- *The ITD may consider bringing in a new provision in the Act to stipulate that voluntary contributions received from other Trusts/Institutions out of current year’s income shall not be eligible for the permissible accumulation at the rate of 15 per cent in the hands of such recipient trust or institution.*

(Paragraph 5.1.2.7)

- *The ITD may evolve a suitable mechanism by issuing a Standard Operating Procedure for Assessing Officers for carrying out physical inspection of the activities of the trust*

in cases where there had been consistent and increased accumulation to ensure that trusts are allowed accumulations consistently only in exceptional cases.

(Paragraph 5.1.2.9)

- *The ITD may stipulate specific parameters (apart from the donor's name and address) such as PAN etc., which must be disclosed by assessee to establish the identity of donors. Further, disclosure of PAN of the donor should be made mandatory above a threshold limit of donation to be decided by the ITD. ITD may also consider introducing a new Schedule in the ITR to capture the donors' details in order to strengthen the assessment procedure to mitigate the risk of money laundering and prevent leakage of revenue.*

(Paragraph 5.1.2.10)

- *The ITD may ensure that field enquiry about the existence and genuineness of the activities of the Trust/Institution may be conducted and a report thereof with necessary documentation may be kept on record while granting registration.*

(Paragraph 5.2.5)

- *The ITD may take steps to strengthen the IT system so that input of data should commensurate with the selection criteria for proper identification of cases to be scrutinised.*

The ITD should consider expanding the data elements captured in ITR 7, if need be, restricted based on a gross income or exempted income threshold to be determined by the ITD. This will enable capturing of relevant data enabling a better and more risk-based approach to CASS selection without inconveniencing smaller trusts/entities.

(Paragraph 5.3.1)

- *The ITD may*
 - (a) consolidate registration data of all the Trusts/ Institutions registered under Section 12AA/80G/10(23C) of the Act digitally and match it with the data filled in ITRs to verify genuineness of registration while processing of ITRs through CPC; and*
 - (b) suitably modify the second proviso to Section 12A(2) to enable the AO to re-open such cases where assessee has claimed irregular exemption under Section 11 or 12 without having a valid registration.*

(Paragraph 5.3.2)

- *The ITD may capture data/information relating to contributor/donor in Form ITR-7 as has been done in respect of Section 80G (5) to bring transparency and accountability for the funds contributed/donated.*

(Paragraph 5.3.5)

- *The ITD may consider modifying Form 10B incorporating:*

- (a) *details of receipt under different heads and income derived from property wholly held by trust.*
- (b) *detailed information on receipt of corpus donations, its utilisation and claim of expenditure from corpus donation.*
- (c) *detailed information on the claim of deemed application of income availed in a previous year which has to be reduced from the amount of application of income in the year of actual receipt.*
- (d) *the details of utilisation out of past accumulation in the return of income is certified by the Auditor.*

to enable the Assessing Officer to verify the correctness of the claim made by the assessee.

(Paragraph 5.3.6.1, 5.3.6.2, 5.3.6.3 and 7.1.11)

- *The ITD may strengthen its assessment procedure for Trusts/Institutions to ensure that no exemption is granted when income or property of the trust is utilised for the benefit of persons having substantial interest.*

(Paragraph 6.4)

- *The ITD may allocate separate codes to different classification of activities of Trusts/Institutions, linking them with Section 11 and sub-Sections of 10(23C) of the Act, for identification of Government and private entities, for better monitoring, improved vigilance in regard to private charitable entities and effective evaluation of risk for scrutiny selection.*

ITD's Computer Aided Scrutiny Selection (CASS) may be refined to reflect the lower risk for Government entities and reduce the probability of selection for scrutiny, other things being equal. This is important because ITD resources for scrutiny are limited and should be better deployed to higher risk cases in private sector.

(Paragraph 7.1.1)

- *The ITD may issue instructions to bring the cases approved under Section 10(23C) and 80G(5) of the Act under the purview of internal audit of the Department.*

(Paragraph 7.1.4)

- *The ITD may*
 - (a) *capture data in the CPC-ITR/ITBA system, to ascertain the nature and activity of the concerned trusts through granular business codes and other means; and*
 - (b) *enhance the quantum of surveys being undertaken in respect of private educational Trusts/Institutions, particularly the high value exemption cases, so as to ensure more effective monitoring and minimize the possibility of ineligible claims, as desired by the PAC.*

(Paragraph 7.1.5)

- *The ITD may consider issuing Standard Operating Procedure/Guidelines ensuring the genuineness of the activities of Trusts/Institutions before grant of registration/ accord of approval.*

(Paragraph 7.1.8)

- *The ITD may consider certification of research activity of a Trust/Institution by specialised authority at the time of granting approval under Section 35(1)(ii) in line with Section 35(2AA) and 35(2AB).*

(Paragraph 7.1.9)

- *The ITD may devise a monitoring mechanism (in addition to scrutiny assessment) to ensure that the entities which are availing the benefits under Sections 10(23C), 11, 12, 13, 80G(5) of the IT Act, are working towards achieving the objectives for which they are formed.*

(Paragraph 7.1.10)

- *Form 10BB may be modified so as to monitor amounts accumulated by the Trusts/Institutions registered under Section 10(23C) (iv to via). Further, ITD may consider specific declaration to be made by the assessee similar to Form 10, as per which statement to be furnished to the AO/prescribed authority under Section 11(2), intimating the purpose/ period of accumulation, by Trusts/Institutions registered under Section 10(23C) (iv to via), opting for accumulation of income for future application. Further, CPC-ITR/ITBA system may also be suitably modified to maintain a schedule of year-wise accumulation and utilisation by automatic capture of data so that any unspent amount after specified period may be taxed accordingly.*

(Paragraph 7.1.12)

- *The ITD may*
 - (a) evolve an automated IT-based mechanism to cross-verify the foreign receipt available with MHA, with that in the ITR. The ITD may also consider bringing in new provisions in the Act, so as to treat foreign contribution received, utilized, donated or invested by Trusts/Institutions in violation of the FCRA Act 2010 as income not to be exempt under Section 11 and 10(23C).*
 - (b) put checks and validation in place in the ITD systems to restrict the user to provide inconsistent information/data within same/different Forms while filing ITR.*
 - (c) explore the feasibility of utilisation of relevant information/data available with the other Government Department/body which may plug-in leakage of revenue to the exchequer while processing ITRs in an automated environment.*

(Paragraph 7.1.13)