

### Chapter 3: Assessments

**3.1** ITD has 5.60 lakh, 5.96 lakh and 6.64 lakh total registered Trusts in FY 09, FY 10 and FY 11 respectively in 3831 assessment units<sup>12</sup>. The average annual growth of number of Trusts during FY 09 to FY 11 was 8.9 *per cent*. We identified 1.37 lakh assessments of Trusts (Scrutiny: 0.17 lakh & Summary: 1.20 lakh) in 554 assessment units. We checked 0.81 lakh assessment cases (Scrutiny: 0.15 lakh & Summary: 0.66 lakh). We have highlighted 1,211 (Scrutiny: 1019 & Summary: 264) objections of irregular exemption involving tax effect of ₹ 3,019.21 crore in this AR. The objections on scrutiny cases constitute 6.5% of total scrutiny cases test checked by audit and are summarized in Chapter 3, 4 and 5.

**Twenty two Trusts accumulated surpluses of ₹ 819 crore ranging from 35.7 to 84.8 percent of their total income. These surpluses were used for creating fixed assets for earning more profit or transferred to other Trusts rather than charitable purpose to avoid tax.**

#### Irregular exemption to Trusts creating huge surpluses consistently

**3.2** Section 11(2) of Act provides that if application of funds is less than 85% of the total income, Trusts, in order to get exemption, can accumulate such funds for five years after submitting Form 10 to AO before filing return of income. Section 11(1)(d) provides that donations received with specific directions are credited to corpus of Trust fund and accumulated for utilization in future. However, Act does not prescribe the limit of accumulation of funds and Trusts are availing exemptions by accumulating maximum funds consistently year by year.

**3.3** We observed that 22 education institutions in Delhi, Mumbai, Pune, Chennai, Coimbatore, Kolkata and Odisha had huge excess of income over expenditure of ₹ 819.40 crore during AY 07 and AY 11 and accumulated these surpluses ranging from 35.7 to 84.8 *per cent* of their total income. Illustrations of 10 institutions are as shown in table 3.1 below:

Trust and charge	AY	Income	Expenditure	Lakh ₹	
				Surplus	Surplus %
a. Tatwajana Vidyapeeth, DIT-E, Mumbai	AY 08	495.37	75.19	420.18	84.82
	AY 09	557.32	128.49	428.83	76.94
	AY 10	508.41	78.46	429.95	84.57
b. Ishan Educational Research Society, DIT-E, Delhi	AY 07	358.90	168.58	190.32	53.02
	AY 08	488.14	203.75	284.38	58.26
	AY 09	588.98	206.83	382.15	64.90
	AY10	907.51	268.38	639.13	70.42
c. Symbiosis Open Education Society, CIT-I, Pune	AY 10	9554.51	1,599.43	7,955.08	83.26

<sup>12</sup> As on March 2010

d. Symbiosis Society, CIT-I, Pune	AY 09	31087	12,053	19,034	61.23
	AY 10	30626	15,369	15,257	49.82
	AY 11	33,339	16,140	17,199	51.59
e. Adarsh Educational Trust Erode, CIT-II Coimbatore	AY 08	4.22	2.61	1.61	61.80
	AY 09	6.94	2.48	4.46	35.70
f. Shanti Education Society, DIT-E, Delhi	AY 09	612.92	299.25	313.67	51.17
g. GRD Trust, CIT-I Coimbatore	AY 10	15.48	8.02	7.46	51.80
h. Saraswathi Educational Trust, Erode, CIT-II Coimbatore	AY 11	2.23	1.19	1.04	53.30
i. Ritnand Balved Education Foundation, DIT-E, Delhi	AY 10	50,066.62	31,860.37	18,206.25	36.36
<b>Total</b>		<b>1,59,219.55</b>	<b>78,465.03</b>	<b>80,754.51</b>	

**3.4** Table 3.1 indicates that three institutions namely **Tatwajnana Vidyapeeth**, DIT-E, Mumbai, **Ishan Educational Research Society**, DIT-E, Delhi and **Symbiosis Society Group**, CIT-I, Pune earned profit ranging from 50 to 84 per cent consistently during AY 07 and AY 11 and accumulated surpluses ₹ 622.20 crore.

**3.5** *The Ministry stated (May 2013) that accumulation of surplus upto 15% is allowed u/s 11(1) and beyond 15% too, it can be accumulated upto 5 years u/s 11(2) by filing Form 10. Therefore accumulation of surplus is permitted by law. The prescription of limit is not desirable or practical as funds are required to be accumulated for infrastructure development and other purposes as per specific needs.*

**3.6** *Audit has not questioned the legality of section 11(1) & 11(2) but pointed out instances of accumulations consistently citing illustration of misuse of such accumulations. In the case of CIT vs Sree Seetharama Anjaneya Veda Kendra (2008) 174 Taxman 523 (Ker.), it was held that the carry forward of income up to 85 per cent, though permitted u/s 11(2) of the Act, should not be adopted on a routine basis and if it is done, then the very purpose of Trust will be defeated. In fact, section 11(2) providing for carry over up to 85 per cent is an exception and if it is followed from year to year, then the genuineness of the activities of Trust itself should be examined by the AO.*

**3.7** *The Ministry, in the Direct Tax Code, had also proposed that Trusts (Non Profit Organizations) apply at least 85 percent of income in the year to avail exemption. In order to restrict the misuse of accumulations, the Ministry may bring suitable amendment to the Act or evolve a suitable mechanism so that Trusts are not allowed accumulations consistently through strict monitoring of Form 10 invariably in all the cases to cover all assessments whether in summary/scrutiny.*

**ITD allowed irregular exemptions to Jamshetji Tata Trust and Navajbai Ratan Tata Trust who invested ₹ 3,139 crore in prohibited modes arising from accumulations of capital gains which involved tax effect of ₹ 1066.95 crore.**

**Irregular exemption of capital gains arising from accumulated funds**

**3.8** Section 13(1)(d) provides that provisions of section 11 or 12 will not be applicable if any funds of Trusts are invested in other than shares in a public sector company or shares as prescribed under section 11(5)(xii). Calcutta High Court<sup>13</sup> held that the term “income” includes “capital gains”, and therefore it should have been invested within the same year or the next year, as contemplated in section 11(1A).

**3.9** We noticed that 14 Trusts cases involving tax effect of ₹ 1090.03 crore where accumulations arising from capital gains were not either invested in specified mode or computed correctly. Moreover, in some cases, they did not fully utilize the sale proceeds for acquiring other capital assets. ITD allowed exemption irregularly in these assessments completed after scrutiny (see Box 3.1).

**Box 3.1: Illustrative Case**

In Maharashtra, DIT-E, Mumbai, **Jamshetji Tata Trust** and **Navajbai Ratan Tata Trust** earned ₹ 1,905 crore and ₹ 1,234 crore on account of capital gain during AY 09 and AY 10 respectively and invested the same in prohibited mode of investments which is in contravention to the provisions of section 13(1)(d) of Act. Thus, AO should have brought investment aggregating ₹ 3139 crore to tax at maximum marginal rate as per provision under section 164(2) read with proviso there under. It resulted in short levy of tax of ₹ **1066.95 crore**.

**3.10** *The Ministry accepted (May 2013) the audit observations as illustrated at Box 3.1 and initiated remedial action. However they stated that the number of cases in which prohibited investment was found by audit is only 14 cases, though the tax effect is very large in the illustrative cases. These cases are being examined.*

**3.11** *Audit is of the view that the Ministry may, in addition to examining the above cases, accept, in principle, that such mistakes should not occur at least in scrutiny assessments as pointed out in above cases. The Ministry needs to evolve effective monitoring system to make AOs responsible to check investments in unauthorized modes in all the cases.*

**3.12** *The Ministry stated (July 2013) that the mechanism already exists, the scrutiny assessments made by the AOs are subject to internal audit. CBDT is also providing training to the officers who are making assessments of Trusts.*

**3.13** *Audit is of the view that such mistakes have been noticed in scrutiny assessments and internal audit also failed to detect them despite existing mechanism and training.*

<sup>13</sup> CIT Vs. East India Charitable Trust (1996) 206 ITR 152

**In 25 cases, Trusts transferred accumulations to other Trusts treating as application of income which resulted in short levy of tax of ₹ 32.52 crore.**

**Irregular transfer of accumulations to related Trust**

**3.14** Explanation to sub section (2) of section 11 prohibits donation to other Trusts out of accumulated funds. However, there is no ban on transfer of payments to other Trusts out of current year's income subject to provisions of section 11(3).

**3.15** We observed that in 25 Trusts cases, Trusts had accumulated income and transferred to other Trusts treating it as application of income. This resulted in underassessment of income with short levy of tax of ₹ 32.52 crore (see Box 3.2).

**Box 3.2: Illustrative Cases**

In DIT-E, Mumbai, three Trusts namely **F.E. Dinshaw Trust** (AY 09 and AY 10), **F.E. Dinshaw Charities** (AY 05, AY 06 and AY 09) and **Manubhai Foundation** (AY 08 and AY 09) were irregularly transferring unspent amounts of accumulations to other related Trusts to avoid taxation. Irregular transfer of ₹ 3.25 crore in these cases involved tax effect of ₹ 1.04 crore.

**3.16** *The Ministry stated (May 2013) that these are exceptional cases and are being examined.*

**3.17** *Audit is of the view that instead of accepting these cases as exceptional, the Ministry may bring suitable amendment in Act to prohibit donations to other Trusts out of current income to restrict misuse of availing statutory deductions of 15 percent provided in Act. It would also curb the practice of Trusts of transferring current income to their sister concerns.*

**Four Trusts disbursed interest free loan of ₹ 14.85 crore to escape taxation involving short levy of tax of ₹ 6.23 crore.**

**Irregular transfer of money as interest free loan to avoid taxation**

**3.18** Many Courts have held in their judgments<sup>14</sup> that Trusts disbursing loan without proper interest or collateral are not entitled for exemptions. As per circular no. 100 of 1973, the disbursement of loan was to be considered as application only if the loans were advanced by an educational trust to students for higher studies if (a) the object of the trust is to give interest bearing loans for higher studies and (b) when it is offered as income at the time of repayment.

**3.19** We observed that ITD allowed irregular exemption to four Trusts who disbursed interest free loan of ₹ 14.85 crore to escape taxation involving short levy of tax of ₹ 6.23 crore (see Box 3.3).

**Box 3.3: Illustrative Case**

In DIT-E, Mumbai, an assessee **Shree Raj Foundation** made additional accumulations vide explanation to section 11(1) during AY 09 and AY 10 despite its actual application on the charitable purposes being very low. As the expenditure on the objects of Trust was non-existent during the year, the assessee used to show huge amounts of disbursements as interest free and unsecured loans and claimed loan disbursements as application. The advancement of irregular loan advances was to avoid taxation resulting in income of ₹ 5.25 crore escaping assessment with consequential tax effect of ₹ 1.77 crore.

<sup>14</sup> Ram Bhavan Dharmshala Vs State of Rajasthan 258 ITR 725 (Raj); Smt. Gomti Devi Banarsidas Vaid Charitable Trust Vs ITO (1986) 16 ITD 308 (All)

**3.20** *The Ministry accepted (May 2013) the audit observation illustrated at Box 3.3 and initiated remedial action. The Ministry further stated that advancement of loan without interest attracts provision of section 13 only if it is given to interested persons. The Board's circular is with reference to educational loan but cannot be taken as prohibiting other loans.*

**3.21** *The Ministry's stand is not acceptable as Board's circular specifies consideration of application of income **only if** the loans were advanced by an educational trust to students for higher studies provided the object of the trust is to give **interest bearing** loans for higher studies. The advancement of loan without interest is also against the Court decisions cited above.*

**3.22** *The Ministry further stated (July 2013) that there is no blanket ban on loan being given by Trusts to any particular person. However there should not be violation of section 13 meaning thereby that benefit should not be conferred on trustees or donor or settler etc. which is against the provision mentioned in section 13.*

**3.23** *Audit reiterates its view because disbursement of loan does not come under any category of charitable purposes envisaged u/s 2(15) of Act. Furthermore, CBDT circular No. 100/1973 specifies the situation where it amounts to application of income only if the loans were advanced by an educational trust to students for higher studies and that too with interest. It means disbursement of interest free loan should not be considered a charitable activity.*

**ITD allowed irregular exemptions to three Trusts who earned substantial income by accepting capitation fee in addition to other prescribed fee resulted in short levy of tax of ₹ 8.88 crore.**

#### **Irregular exemption to the institutions receiving donations/capitation fee**

**3.24** *The Supreme Court has held<sup>15</sup> that every institution is free to devise its own fee structure subject to the limitation that there can be no profiteering and no capitation fee can be charged directly or indirectly, or in any form. The Supreme Court held<sup>16</sup> that the educational institutions could not charge more than the fees fixed by the Government in any form either as donation, capitation fee etc.*

**3.25** *We observed that AOs allowed irregular exemption to three Trusts who received capitation fee in addition to normal fee. This resulted in tax effect of ₹ 8.88 crore (see Box 3.4).*

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<sup>15</sup>T.M.A. Pai Foundation & Others Vs. State of Karnataka & Others (SC- 31/10/2002),

<sup>16</sup>Unnikrishnan J P & others Vs State of Andhra Pradesh & others 1993 AIR 2178 SC (1) 594

**Box 3.4: Illustrative Case**

In DIT-E, Kolkata, **Bhawanipur Gujrati Education Society and Multiple Educational & Manpower**, engaged in the business of imparting education, accepted capitation fees of ₹ 354.61 crore during the AY 08 to AY 10<sup>17</sup>, in addition to other prescribed fees which was required to be brought to tax. Omission resulted in non levy of tax of ₹ 8.88 crore.

**3.26** *The Ministry stated (May 2013) that objection was raised in three cases out of which one is summary assessment. These are exceptional cases and will be looked into. The Ministry further stated (July 2013) that in box cases, Audit has held development fees/donations received by the educational institutions as being in the nature of capitation fees collected with profit motive. But Audit overlooked the fact that income derived from development fees was duly credited in the respective Income & Expenditure Account and both the entities had applied its income for the year to the extent of 85% for charitable purposes as laid down u/s. 11(1)(a) of Act. Therefore, no adverse view could be taken in this regard, especially considering the fact that both the entities were also approved u/s. 10(23C)(vi) for the relevant AY.*

**3.27** *The Ministry's view is not tenable as mere accounting of donation/capitation fees cannot be sufficient ground to legalise these funds which have been held illegal by the Apex court and therefore, required to be taxed.*

**ITD allowed irregular exemptions of TV subsidy received from BCCI to four Cricket Associations engaged in commercial activity which resulted in non levy tax effect of ₹ 37.23 crore.**

**Irregular exemption to Cricket Associations engaged in commercial activity**

**3.28** Section 2(15) of Act prescribed that from AY 10 onwards advancement of any other object of general public utility shall not be treated as "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, if the aggregate value of the receipts from the activities exceeds ₹ ten lakh in the previous year.

**3.29** We observed that DIT-E, Ahmedabad (06 December 2010) cancelled registration granted u/s 12A to **Gujarat Cricket association** from FY 05 onwards concluding that practice followed by the assessee trust treating TV rights from BCCI as corpus was not in order as it was purely commercial receipt within the ambit and scope of aforesaid proviso to section 2(15) of Act. AO (30 December 2011) did not allow exemption to the assessee Trust on the amount of TV rights income from BCCI during the AY 10.

**3.30** However, ITD allowed exemption in four similar cases for the income received from TV rights from BCCI in cases of **Saurashtra Cricket Association, Baroda Cricket Association, Kerala Cricket Association and Maharashtra Cricket Association** resulting in short levy of tax of ₹ 37.23 crore (see box 3.5).

<sup>17</sup> Assessments of Bhawanipur Gujrati Education Society & Multiple Educational & Manpower, for the AY 08 to AY 10 were completed after scrutiny in December 2009 and 2010

**Box 3.5: Illustrative Case**

In Gujarat, CIT-II Rajkot, **Saurashtra Cricket Association** received TV subsidy of ₹ 8.02 crore, ₹ 13.81 crore and ₹ 13.34 crore from BCCI during AY 08, AY 10 and AY 11 respectively on organizing various tournaments. Further assessee had also generated advertisement sales income of ₹ 1.12 crore during the one-day match on 14 November 2008 at Rajkot and only a small portion of receipts (1.5 per cent of gross receipts) were spent for “the promotion and development of sports” and it accumulated ₹ 19.44 crore. This resulted in under-assessment of ₹ 19.44 crore with short levy of tax of ₹ 8.45 crore.

**3.31** *The Ministry stated (May 2013) that in the case of Gujarat Cricket Association, the Hon’ble ITAT, Ahmadabad has restored the registration u/s.12A which was cancelled by the DIT (E), Ahmadabad. ITD has filed an appeal in Gujarat High Court against the order of ITAT. They further stated that there is no need to cancel registration as AO can deny exemption u/s 11 on year to year basis. Further, the scope of cancellation u/s 12AA is restricted only to cases where the activities are not according to objects or the activities are not genuine.*

**3.32** *Audit has commented upon irregular exemption to Cricket Associations engaged in commercial activity and not on registration. However, ITD has gone in High Court against cancellation of the registration. ITD may therefore review the exemption granted to the assessee in these cases.*

**ITD allowed irregular exemptions to 30 Trusts involving tax effect of ₹ 59.61 crore where voluntary contributions, received without specific directions, were taken to corpus fund instead of treating as income.**

**Irregular exemption of anonymous donations /voluntary contributions**

**3.33** Section 115 BBC of Act provides that where the total income of Trust includes any income by way of anonymous donations, tax shall be paid on total anonymous donations. Section 11(1)(d) of Act provides that any voluntary contributions made with a specific direction that they will form part of the corpus, shall not be included in the total income of the organization.

**3.34** We observed that AOs allowed treatment of voluntary contributions received without specific directions as income in corpus fund of the assessees in 30 cases. This resulted in non-levy of tax of ₹ 59.61 crore (see box 3.6).

**Box 3.6: Illustrative Case**

In DIT-E, Delhi, **Technology Development Board**, notified u/s 10(23C) (iv), during AY 09, received voluntary contribution of ₹ 14.42 crore which was taken to corpus fund and not treated as income. This resulted in non-assessment of income of ₹ 14.42 crore and consequent non-levy of tax of ₹ 5.49 crore.

**3.35** *The Ministry stated (May 2013) that the legal position is correct. However, the individual cases will be examined for applicability on facts.*

**3.36** *Audit has not questioned the legal position. However, provisions of Act are not being complied properly. The Ministry, besides examining the cases, may evolve a system that such mistakes are minimized in future.*

**3.37** *The Ministry further stated (July 2013) that the mechanism already exists and the scrutiny assessments made by AOs are subject to internal audit. CBDT is also providing training to the officers who are making assessments of trusts.*

**3.38** *Audit reiterates its view since despite the existing mechanism in Act, the mistakes have been noticed in the scrutiny assessments.*

**ITD allowed irregular exemptions to 48 Trusts involving tax effect of ₹ 28.01 crore where trusts were carrying out commercial activities and did not maintain separate books of accounts.**

#### **Exemption granted to Trusts for trading/commercial activities**

**3.39** Section 11 of Act shall not apply in relation to any income of a Trust or an Institution being the profits and gains of business unless the business is incidental to the attainment of the objective of Trust and separate books of accounts are maintained by such Trust or Institution in respect of such business under Section 11(4A).

**3.40** We noticed that ITD allowed exemptions in 48 cases involving tax effect of ₹ 28.01 crore where Trusts were carrying out commercial activities and separate books of accounts were not maintained (see box 3.7).

#### **Box 3.7: Illustrative Case**

In Maharashtra, DIT (Exemption), Mumbai charge, an assessee “Sameeksha Trust” was carrying on the activity of publishing of journal named “Economic and Political Weekly” and books and was collecting subscription charges on commercial basis from the readers. Thus, it is clear that the assessee was running business activity in the garb of charity and the grant of exemption was irregular. The loss on account of non-taxing non-charitable activities resulted in underassessment of income of ₹ 2.24 crore, ₹ 6.23 crore and ₹ 3.89 crore with a consequential tax effect of ₹ 75.55 lakh, ₹ 2.11 crore and ₹ 1.31 crore during AYs 08, 09 and 10 respectively.

**3.41** *The Ministry stated (May 2013) that each case pointed out by audit will be examined on facts. However, incidental business and commercial activity is permitted by law except in the case of Trusts having object of general public utility.*

**ITD allowed irregular exemptions to 28 Trusts involving tax effect of ₹ 11.74 crore where Trusts violated the provisions of section 13 of Act.**

#### **Irregular exemption by violation of provisions of section 13 of Act**

**3.42** Section 13 of Act provides that exemption to charitable trusts available under section 11 or 12 would not be available if any income or property of Trust is applied for the benefit of any particular religious community/ caste or directly or indirectly for the benefit of any person referred to in section 13(3) or any funds of Trust are invested or deposited otherwise than in any or more of the forms or modes specified in section 11(5).



**3.43** We observed that ITD allowed exemptions in 28 cases involving tax effect of ₹ 11.74 crore where the assessee Trusts violated the provisions of section 13 of Act (see box 3.8).

**Box 3.8: Illustrative Case**

In Karnataka, DIT-E, Bangalore and CIT Mangalore, three trusts namely **Mahatma Gandhi Vidya Peetha Trust** (AY 09), **Nagarjuna Educational Society** (AY 09) and **Alva's Education Foundation** (AY 10) made payments for the benefit of interested persons specified in section 13(3) and the entire income of ₹ 11.13 crore was allowed as exemption u/s 11 instead of bringing it to tax. The omission resulted in irregular exemption of like amount involving tax effect of ₹ 3.91 crore.

**3.44** *The Ministry stated (May 2013) that payment to interested person attracts provision of sec 13(3) only if the same is unreasonable. There is no general ban on making any payment to interested persons as per section 13(3). Only thing required to be examined is that the payment made to the interested persons is reasonable considering the nature of activity or benefit taken by Trust.*

**3.45** *Audit of the view that the Ministry may reiterate instructions for AOs to be made responsible for irregular exemption by violation of provisions of section 13 of Act.*

**ITD allowed exemption on accumulated amounts to 11 Trusts involving tax effect of ₹ 99.63 crore though Trusts lost charitable character.**

**Exemption of accumulation u/s 11(2) despite assessee losing charitable character**

**3.46** Accumulation under section 11(2) is exempt subject to its application for stipulated period on the charitable objects of Trust. Section 11(3)(a) provides that, if in any year income accumulated for specific purpose or purposes of Trust is applied to purposes other than charitable or religious purposes or ceases to be accumulated or set apart for application of such purposes, it will become chargeable to tax as the income of the year.

**3.47** We noticed that ITD allowed exemption in 11 case involving tax effect of ₹ 99.63 crore where Trusts lost charitable character (see box 3.9).

**Box 3.9: Illustrative Case**

In DIT-E., Mumbai, **Credit Guarantee Fund Trust for Micro and Small Enterprises** was assessed for AY 10 under normal provisions and not as Trust in accordance with amendment in section 2(15) holding its objects non-charitable in nature and cancelling registration u/s 12AA. Since the assessee was no longer a charitable trust, the unused accumulation u/s 11(2) of AY 08 and AY 09 amounting to ₹ 94.39 crore and ₹ 154.62 crore respectively was required to be taxed in the current year. Therefore, AO did not bring the accumulations of previous years as income which resulted in underassessment of income of ₹ 249.01 crore with a tax effect of ₹ 84.63 crore.

**3.48** *The Ministry stated (May 2013) that if exemption is denied in one year but registration continues (which is permissible as per scheme of the Act), the accumulated surplus cannot be taxed unless period of five years is over.*

**3.49** *The Ministry may reconsider their reply as Audit pointed out the cases where registration has also been cancelled as Trusts lost its charitable character, action is required to tax unused accumulations also.*

**ITD allowed exemption in 4 case involving tax effect of ₹ 6.52 crore where income was not derived from property held under Trust.**

#### **Irregular exemption to income not derived from property held under Trust**

**3.50** Exemption under section 11 of Act is allowable to income derived from property held under Trust for charitable or religious purposes in India. Voluntary contributions received by Trust is also deemed to be an income derived from property held under Trust as provided u/s 12(1) of Act. Thus, if income is derived from property which is held by any institution/organization other than Trust, such income is not eligible for exemption.

**3.51** We observed that ITD allowed exemption in 4 case involving tax effect of ₹ 6.52 crore whose income were not derived from property held under Trust (see box 3.10).

#### **Box 3.10: Illustrative Case**

In Gujarat, CIT Gandhinagar, the total receipts of **Gujarat Council of Science City** for AY 07 were ₹ 39.76 crore out of which an amount of ₹ 5.96 crore (15% of the total receipt) was allowed to be set apart under section 11(1)(a) of Act and the remaining income of ₹ 6.04 crore was taxed. As the income of the assessee institution was not derived from property held under Trust, the exemption granted under section 11(1)(a) of Act was irregular. The irregular exemption resulted in under-assessment of income ₹ 5.96 crore involving short levy of tax of ₹ 2.65 crore. ITD accepted the observation and took remedial action (November 2011).

**3.52** *The Ministry stated (May 2013) that there are only 4 cases.*

**3.53** *Audit is of the view that the Ministry may examine the above cases and take remedial action.*

**ITD allowed irregular exemptions to 22 Trusts involving tax effect of ₹ 5.53 crore while computing 15 percent income on gross basis instead of net income.**

#### **Excess allowance of exemption granted under section 11(4) read with section 11(4A)**

**3.54** Madras High Court has held that “only net income can be considered for application and accumulation”<sup>18</sup>. As per Board’s circular<sup>19</sup>, the income of Trust has to be computed in terms of commercial principles and not as per other provisions of Act.

<sup>18</sup>223 ITR 831 (Madras HC)(1997) - CIT VS PSG & Sons Charities

<sup>19</sup> CBDT Circular No. 5P (LLX-6) dated 19/06/1968.

Hence, 15 per cent of the income derived from the property held under Trust shall be of the net income after meeting all the expenditure to earn the income and not of the gross receipts.

**3.55** We observed that in 22 Trust cases involving tax effect of ₹ 5.53 crore, computation of income was inconsistent (see box 3.11).

**Box 3.11: Illustrative Case**

In Kerala, CIT Kochi, **Lissie Medical Institute**, engaged in the business of running Multi-Specialty Hospital, School of Nursing, College of Pharmacy etc., computed the net business income before allowing depreciation and establishment expenses. Assessee claimed depreciation and establishment expenses from the above net business income as application of income. AO, while completing the assessment for AY 10 after scrutiny, considered only the net income. However, while completing the assessments for the AY 07 and AY 08, AO disallowed depreciation and allowed exemption on the gross receipt instead of net business income. This resulted in under assessment of taxable income of ₹ 2.49 crore and ₹ 20.78 lakh in two AYs respectively with a total tax effect of ₹ 1.19 crore.

**3.56** *The Ministry stated (May 2013) that the legal position stated by audit is not correct. In section 11, the word 'income' refers to the gross income received from property of Trust and not net income. It appears that audit wing in Kerala alone is taking this objection.*

**3.57** *Audit is of view that the Ministry may clarify the position after taking consideration upon the Madras High Court judgment.*

**ITD allowed irregular exemptions to two Trusts involving tax effect of ₹ 41.01 crore to Investor Protection Funds under section 11 and 10(23EA) simultaneously.**

**Irregular grant of exemption to Investor Protection Funds (IPDs)**

**3.58** Section 10(23EA) provides that income of IPD by way of contributions received from recognized stock exchanges and the members thereof, alone, would be tax-exempt and all other income of IPD would become taxable. However, the IPDs started taking exemptions as Trusts under section 11 for such taxable income and they were claiming exemptions both under section 11 and 10(23EA) of Act.

**3.59** **The Stock Exchange Investor Protection Fund** was created with the specific objective of establishing a fund for the benefit of the customers of the members of Bombay Stock Exchange and the nature of fund was very restrictive. It gave benefits only to those persons who actually did the trade through the exchange's member on the exchange. Trust was dissolvable on dissolution of the Stock Exchange and the proceeds of the assessee was not to be given to any other Trust but would be shared with the Stock Exchange. Thus, the nature of the fund is more of a business facilitator of the Stock Exchange and non-charitable in nature (see box 3.12).

**Box 3.12: Illustrative Case**

In DIT-E, Mumbai, AO allowed irregular exemption under section 11 and 10(23EA) simultaneously of ₹ 123.7 crore involving tax effect of ₹ 41.01 crore to **Stock Exchange Investor Protection Fund & National Stock Exchange Investor Protection Fund**, during AY 08 to AY 10.

**3.60** *The Ministry stated (May 2013) that the cases will be examined for applicability on facts.*

**AOs allowed irregular exemption on dividend income involving tax effect of ₹ 163.66 crore under section 10(34) and 10(35) in 20 cases though it was not applied for the purpose of Trust.**

**Irregular exemption within exemption relating to Dividend**

**3.61** Section 11 to 13 deals with the quantum of income from the property held under charitable or religious Trusts which will not form the part of total income. Method of computation of such quantum is based on application of income generated from the property of Trust/ received by Trust. Any exclusion of income will not only defeat the basic purpose of this computation but also defeat the purpose of Chapter III which deals with “Incomes which do not form part of total income”. Dividend income prescribed u/s 10(34) and 10(35) is not covered u/s 11 to 13 applicable to Trusts.

**3.62** We noticed that AOs allowed exemption on dividend income u/s 10(34) and 10(35) though it was not applied for the purpose of Trust in 20 cases involving tax effect of ₹ 163.66 crore (see box 3.13).

**Box 3.13: Illustrative Case**

In DIT-E, Mumbai, AO allowed exemptions of dividend income of ₹ 89.26 crore under section 10(34) and 10(35) to **Sir Dorabji Tata Trust** during FY 09. AO should not have allowed this as income was not applied for the purposes of Trust. The omission has resulted in irregular allowance of exemption with potential tax effect of ₹ 30.34 crore.

**3.63** *The Ministry stated (May 2013) that dividend incomes which are exempt under section 10(34)/10(35) cannot be further subjected to conditions mentioned in section 11 for application of income purposes. Such dividend income would also be exempt in hands of charitable institutions. Only condition which will apply is regarding investment of such income which will have to be made in accordance with provision of section 13(1)(d), in the modes specified in section 11(5). All the mistakes are being looked into.*

**3.64** *Audit is of the view that the Ministry may consider all the provisions of section 11/12 for application of dividend income instead of only provision of section 13(1)(d) in the modes specified in section 11(5) or make suitable amendment in the Act.*

**Inconsistent stands taken by AOs**

**3.65** Section 13(1)(d) of Act provides that exemption under section 11 would not be available if shares are held in other than public sector company after 30 November 1983 provided such shares were not received by Trust as corpus donation before 1 June 1973.

**3.66** We found cases where AOs took inconsistent stand (see box 3.14).

**Box 3.14: Illustrative Case**

- a.** In ITO Ward 1(4), Pune, AO denied the benefit of exemption to **Dr. Vikhe Patil Foundation, Pune** during AY 09 on the ground that Trust was holding shares in a co-operative bank in violation of section 13(3). However, **Shree Chanakya Educational Society**, holding the shares in three co-operative banks during AY 09 and AY 10 was allowed exemption though both were being assessed in the same charge. This resulted in underassessment of income of ₹ 3.58 crore and ₹ 5.01 crore with tax effect of ₹ 1.22 crore and ₹ 1.70 crore respectively.
- b.** In DCIT Circle 6, Pune, AO allowed exemption to **Raja Shree Shivraya Pratisthan** during AY 09 who was holding shares in two co-operative banks. This resulted in income escaping assessment of ₹ 1.82 crore with a tax effect of ₹ 61.40 lakh.

**3.67** *The Ministry stated (May 2013) that the legal position is correct. Specific cases will be looked into.*

**3.68** *Audit is of the view that the Ministry may initiate remedial action in above cases.*

**AOs took inconsistent stands in 136 cases involving excess accumulations with tax effect of ₹ 72.32 crore where 15 per cent income was set apart at the initial stage.**

**Non uniform treatment of prescribed deduction for accumulation of funds**

**3.69** Section 11(1) of Act allow accumulation up to fifteen *per cent* of income every year, and require balance eighty five *per cent* to be applied for charitable purposes. It was held<sup>20</sup> that it would not be allowed to accumulate 15 % of total income first and then claim excess expenditure for its carry forward to subsequent years. Thus, the accumulation is permissible only to the extent surplus available limited to upper limit of fifteen *per cent*.

**3.70** There is no uniform stand of ITD in treatment of accumulation. Trusts were using this clause as standard deduction and the fifteen *per cent* income was being set apart at the initial stage without verifying whether there is any surplus or not. AOs took inconsistent stands in 136 cases involving excess accumulations with tax effect of ₹ 72.32 crore (see box 3.15).

**Box 3.15: Illustrative Case**

In Gujarat, CIT-Gandhinagar, **Bhanuvijayaji Universal Foundation** had set apart income to the extent of 15% u/s 11(1)(a) even though the actual unapplied income available for set apart was very much less than 15% of gross receipt. The incorrect computation of loss on account of irregular set apart of notional income aggregated to ₹ 2.15 crore with potential tax effect of ₹ 73.12 lakh.

**3.71** *The Ministry stated (May 2013) that the legal position is correct. This aspect is generally taken care of by AOs in scrutiny assessments.*

**3.72** *Audit is of the view that to cover summary assessments, the Ministry may consider suitable modifications in ITR-7 to be processed electronically so that above point is included in computation of income.*

<sup>20</sup> Dawat Institute of Dawoodi Bahra Community Vs. ITO (2008) 22 SOT 359 (Mumbai)

### **Non compliance of provisions of section 11 by the Local Authorities**

**3.73** As per Explanatory notes to Finance Act, 2002, incomes of Housing Boards of the States and of Development Authorities (hitherto being exempt under the provisions applicable to “local authorities”) would be taxable even if they may be deemed to be treated as Local Authorities under any other Central or State Legislation. However, these bodies started taking advantage of provisions of section 11 of Act for exemption of their incomes by getting themselves registered as charitable trusts and institutions.

**3.74** In Maharashtra, ITD denied exemption to **Mumbai Metropolitan Region Development Authority (MMRDA), Maharashtra Industrial Development Corporation (MIDC) and Slum Rehabilitation Authority (SRA)**, holding that they cannot be considered as Trust of any kind. However, these assesseees succeeded in the appeal at the CIT (Appeal).

**3.75** In DIT-E, Mumbai, AO denied exemption to **MMRDA** on grounds of non charitable nature of activities but assesseees succeeded in the appeal and matter was still subjudice on this account. We noticed that MMRDA was not eligible for exemption on the ground that the assessee advanced huge interest free loans ₹ 1992.48 crore to the persons of various Departments and units of Government of Maharashtra, and thus, attracted the provisions of section 13(1)(c). However, ITD did not consider the above aspect of violation of section 13(1)(c) for disallowing the exemption and the above fact was not brought out to the notice of appellate authorities.

**3.76** *The Ministry stated (May 2013) that there is no general rule that local authority cannot claim exemption u/s 11, since apart from Trusts, Companies under section 25, Company Act, Societies under Societies Registration Act etc. are also eligible for registration. It has been judicially held that erstwhile local authorities which enjoyed exemption of their income under section 10(20A) are also entitled for registration under section 12AA after deletion of that section. Only in cases where proviso to section 2(15) is attracted, exemption can be denied by applying section 13(8). The specific objections will be examined.*

**3.77** *Audit is of the view that the Ministry may clarify the position after examination and issue suitable instructions in this regard.*

### **Other mistakes**

**3.78** We also noticed various types of mistakes while allowing exemption to the charitable trust/institutions in 166 cases involving tax effect of ₹ 94.15 crore.

## Recommendations

### 3.79 We recommend that

- a. The Ministry may evolve a mechanism so that Trusts are not allowed accumulations consistently through strict monitoring of Form 10 invariably in all the cases to cover all assessments whether in summary/scrutiny or bring amendment in Act to restrict such accumulations up to a certain limit.

*The Ministry stated (May 2013) that surplus beyond 15 percent can be accumulated up to 5 years under section 11(2) by filing Form 10. Therefore accumulation of surplus is permitted by law. The prescription of limit is not desirable or practical as funds are required to be accumulated for infrastructure development and other purposes as per specific needs.*

*Audit has not questioned the legality of section 11(1) & 11(2) but pointed out instances of accumulations consistently citing illustrations of misuse of such accumulations. The Ministry, in the DTC, had also proposed that Trusts (Non Profit Organizations) apply at least 85 percent of income in the year to avail exemption.*

*The Ministry further stated (July 2013) that since all cases are not taken into scrutiny, it will not be feasible to make physical verification of accumulation and other issues in each and every case. However, the newly notified ITR-7 form already contains a field which requires disclosure of this information.*

*Audit reiterates its views as bulk of the returns of Trusts are finalized under summary only.*

- b. The Ministry may devise an appropriate control mechanism with clearly defined responsibilities to ensure utilization of accumulated funds over a period of time or tax the same.

*The Ministry stated (May 2013) that this aspect is being examined during scrutiny.*

*Audit is of the view that the Ministry may strengthen its internal control mechanism to ensure that mistakes of above nature are minimized in summary assessments also.*

*The Ministry further stated (July 2013) that as per the provisions of section 12A (b) of Act, the accounts of the trusts are required to be audited by an accountant, where the total income of the trust or institution as computed under this Act without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to income tax in that previous year. The utilization of accumulated funds forms part of such audit proceedings. This aspect is also examined during the course of scrutiny proceedings.*

*Audit is of the view that the functions of the ITD held in Act are quasi judicial in nature and cannot be delegated to 3<sup>rd</sup> parties. Moreover, we found mistakes in*

*scrutiny cases also which shows that either provisions of Act are not being complied properly or appropriate control mechanism is lacking.*

- c. The Ministry may evolve effective monitoring system to make AOs responsible to check investments in unauthorized modes in all the cases.

*The Ministry stated (May 2013) that this aspect is being examined during scrutiny.*

*Audit here found mistakes in scrutiny assessments, which shows that these mistakes were not examined in scrutiny; the Ministry therefore needs to evolve a system so that such mistakes do not recur.*

- d. The Ministry may initiate action for withdrawal of exemption /cancellation of registrations/approvals u/s 12A / 10(23C) of Act in case of violation of provisions of section 13.

*The Ministry did not agree (May 2013) on the recommendation but agreed to examine the cases involving violation of Sec 13.*

*Audit of the view that the Ministry may reiterate instructions for AOs to be made responsible for irregular exemption by violation of provisions of section 13 of Act.*