

Chapter 5: Inconsistencies in the Income Tax Act, 1961

5.1 Act does not specifically allow deficit of earlier years, depreciation and repayment of loan in case of exempt entities. In the absence of any express provision in Act, the courts have taken divergent views. ITD has also not taken uniform practice in allowing depreciation, repayment of loan and deficit of earlier years.

ITD has not taken uniform stand in allowance/disallowance of the depreciation to Trusts and allowed irregular depreciation in 240 cases involving tax effect of ₹ 248.39 crore.

Inconsistencies in allowance of depreciation

5.2 The Supreme Court²⁵ (1993) held that where a full deduction has been allowed in relation to capital asset (under section related to exemptions), no depreciation is to be allowed under section 32 on the same asset. There is a fundamental axiom that double deduction is not intended unless there is a clear statutory indication to the contrary. The Kerala High Court (2012) also supported the above view. However, additionally it has been said that if the assessee claims depreciation, then in order to reflect the true income available for application of charitable purposes, it should write back the depreciation amount in the account to form part of its income. Otherwise such notional claim becomes unaccounted cash surplus for the assessee outside its books of accounts.

5.3 ITD allowed depreciation in 240 cases irregularly involving tax effect of ₹ 248.39 crore and had not taken uniform action in allowance/disallowance of the depreciation in Trust cases (see Box 5.1)

Box 5.1: Illustrative Cases

- a.** In Kerala, CIT Kottayam, **Matha Amrithanandamayi Math**, claimed depreciation of ₹ 138.46 crore during AY 07 to AY 09 as application against income from property held under Trust. This was not in order as Trust has not added back depreciation for any of the AYs for which it already claimed deduction for acquisition of capital asset as application of money involving potential revenue impact of ₹ 46.77 crore.
- b.** In DIT-E, Mumbai, AOs allowed depreciation of ₹ 256.66 crore in 50 cases involving revenue impact of ₹ 90.30 crore. AOs disallowed depreciation of ₹ 27.60 crore in 10 cases involving revenue impact of ₹ 9.38 crore.
- c.** In DIT-E, Ahmadabad, AO allowed (November 2009) **BAPS Swaminarayan Sanstha** depreciation of ₹ 52.25 crore during AY 08. Later on, DIT-E, Ahmadabad issued directions (December 2009) to all AOs under its jurisdiction to disallow the depreciation on the ground of double deduction.
- d.** In DIT-E, Delhi, AO did not allow **Vivekanand Shiksha Samiti** depreciation for the AY 10. However, same AO allowed depreciation in the case of **Institute of Chartered Accountants of India** for the AY 10.

²⁵ Escort Ltd. Vs. Union of India(1993) 199 ITR 43

5.4 *The Ministry stated (May 2013) that issue raised by audit will be examined.*

5.5 *Audit is of the view that the Ministry may take a decision, in principle, whether depreciation to Trusts is to be allowed or not to remove inconsistencies in allowance of depreciation due to divergent views expressed by different Courts.*

ITD did not take uniform stand to allow/disallow deficit of earlier years to 110 Trusts involving tax effect of ₹ 327.48 crore.

Inconsistencies in allowance of deficit of earlier years

5.6 In order to claim any relief or benefit under Act, there has to be provision for the purpose. Wherever intended, Act has specifically provided for such reliefs and benefits. As the profits of the business entities are taxed, Act has specifically provided for carry forward of losses in these cases. Act does not specifically allow carry forward of deficit in case of exempt entities.

5.7 The Court has held²⁶ that the assessee can claim in respect of application over and above 100% of gross receipts in any year to be set off in the succeeding years against shortfall. Rajasthan High Court²⁷ has also held that excess of expenditure over income of charitable or religious nature incurred in earlier years can be adjusted against the income of current year. Similar views were expressed by the Gujarat High Court [1995],²⁸ and by the Bombay High Court [2003]²⁹.

5.8 We noticed that ITD had not uniformly allowed/disallowed deficit in 110 cases involving tax effect of ₹ 327.48 crore (see Box 5.2).

Box 5.2: Illustrative Cases

a. In DIT-E, Mumbai, ITD allowed in 38 cases, deficit of ₹ 245.72 crore to be carried forward involving revenue impact of ₹ **83.52 crore**. In 36 cases, deficit of ₹ **420.42 crore** involving revenue impact of ₹ **142.90 crore** was disallowed.

b. In DIT-E, Hyderabad, **A.P. State Housing Corporation** submitted their provisional accounts duly indicating losses for the AY 03 to AY 09 except AY 08 and was processed u/s 143(3). The losses of ₹ 158.7 crore were allowed to be carried forward/set-off which involved potential tax impact of ₹ 53.34 crore.

c. In DIT Delhi, AO allowed setting off of deficit of previous year in case of **Ram Sewa Swami Satyanand Trust**, for AY 10, but the same AO in another case of **Rameshwar Dayal Trust** for the same AY disallowed the same.

5.9 *The Ministry stated (May 2013) that issue raised by audit will be examined.*

5.10 *Audit is of the view that the Ministry may take a decision, in principle, whether deficit of earlier years in case of Trusts is to be allowed or not.*

5.11 *The Ministry further stated (July 2013) that ITD has lost SLP before the Supreme Court and decided not to file SLP on this issue. ITD has opined that the issue has reached its finality.*

²⁶ CIT v. Matriseva Trust vs. 242 ITR 20 (Mad)

²⁷ CIT v. Maharana of Mewar Charitable Foundation [1987] 164 ITR 439 (Raj.),

²⁸ CIT v. Shri Plot Sweatamber Murti Pujak Jain Mandal, [1995] 211 ITR 293 (Gujarat)

²⁹ CIT v. Institute of Banking Personnel Selection 264 ITR 110

5.12 *Audit reiterates its view that the Ministry may issue instructions on the basis of final decision of SLP for bringing uniform approach in dealing with 'Deficit issue'.*

ITD allowed repayment of loans as application of income to 10 Trusts involving tax effect of ₹ 8.56 crore though this amount was already treated as an application of income in the year in which this was borrowed for acquisition of assets.

Inconsistencies in allowance of repayment of loans

5.13 CBDT clarified³⁰ (1973) that repayment of loan originally taken to fulfill one of the objects of Trust will amount to an application of income for charitable and religious purposes. Rajasthan High Court held³¹ that the repayment of any debt or loan should be considered as application of income.

5.14 This circular remained silent on treating the acceptance of loan as income. The allowance of deficit results in double benefit as Trusts have created deficit out of exempt income in some previous year. Again, allowing deficit for the same fund results in re-accumulation of exempt income.

5.15 AOs allowed repayment of loans irregularly in 10 cases involving tax effect of ₹ 8.56 crore as application of income though this amount was already treated as an application of income in the year in which this was borrowed for acquisition of assets leading to dual benefit to the assesseees (see Box 5.3).

Box 5.3: Illustrative Case

In Kerala, CIT Trissur, AO completed assessments of **Divine trust** for AY 08 to AY 10 after scrutiny which revealed that the assessee availed a loan for acquiring asset and the cost thereof was considered as application in the year the amount was borrowed. In this case, AO should not have allowed the repayment of loan as application. Inadmissible loan repayment claimed as application aggregating ₹ 2.31 crore involved total tax effect of ₹ 1.03 crore.

5.16 *The Ministry stated (May 2013) that loan originally taken has to be taken as income/ receipt before application is claimed against it. Without treating as income, application cannot be claimed. The Board's instruction has clarified the allowability of repayment in respect of the loan taken. There was no doubt that the same had to be shown as receipt before claiming application. Since repayment is allowable as per Board's circular and since it has not been pointed out by audit in the cited cases that application had been claimed in earlier years without showing the loan as receipts/ income the audit objection is not on sound footing.*

5.17 *The reply of the Ministry is not acceptable as in all the 10 cases relating to scrutiny assessments, Trusts did not show loan as receipts/income. Out of 10 cases, ITD accepted two cases and initiated remedial action and replies were awaited in remaining cases. The Ministry may therefore examine the facts of the cases and initiate remedial action.*

³⁰ Circular NO 100 dated 24/01/1973

³¹ CIT Vs Maharana of Mewar Charitable Foundation [1987] 164 ITR 439

There is no internal mechanism within ITD to have control over the receipts issued by the entity having registration under section 80G. ITD did not cross-check the donations received by 24 Trusts.

No monitoring system in respect of donations under section 80G

5.18 At present there is no internal mechanism within ITD to have control over the receipts issued by the entity having registration under section 80G. We noticed 24 cases where ITD did not cross check the donation received by the entity (see Box 5.4).

Box 5.4: Illustrative Cases

- a.** In DIT-E, Mumbai, **Shri Lalji Velji Charitable Trust** during AY 10 had received ₹ 4.98 crore as corpus donation from five related parties. However, accounts of donors available on the record did not show such amounts. This was not reconciled.
- b.** In Tamil Nadu, CIT II Trichy & CIT I Madurai rejected 115 applications & 410 applications received from Trusts respectively for approval u/s 80G during FY 09 to FY 11. A test check of returns rejected by Ward I(1), Theni and Circle-I Kumbakonam revealed that donations to the extent of ₹ 71.75 lakh and ₹ 1.11 crore respectively were collected by eleven Trusts. However, there is no system in place to verify as to whether any benefit u/s 80G was extended to the respective donors.
- c.** In ITO 11(1) Pune, an assessee, **Matrix Education Foundation**, received donation of ₹ 24 lakh during AY 09 solely from one of its contractor which had been awarded the contract for building construction. Despite the fact being mentioned in Review Report of Additional Commissioner, ITD did not take any action.
- The Ministry stated (May 2013) that the facts are being verified in all the three cases.

5.19 *The Ministry stated (May 2013) that cross verification cannot be done in all cases but only in high value and suspect cases which is already being done during scrutiny assessment.*

5.20 *Reply of the Ministry is not acceptable as illustrated cases at Box 5.4 a & c relate to scrutiny assessment involving high money value. The Ministry may reiterate instructions in this regard.*

There is no provision in Act to invest corpus fund in specified mode and tax interest earned thereon. In absence of this AOs allowed exemptions on interest earned on corpus fund to two Trusts involving tax effect of ₹ 69.67 crore.

Exemption of interest earned on corpus fund

5.21 There is no clear provision in Act to invest corpus fund and whether interest earned thereon is to be treated as income of the trust. In the absence of clear cut provisions in Act, AOs are allowing exemptions on interest earned on corpus fund.

5.22 We observed that in two cases, AOs treated interest on corpus fund as deemed application involving tax effect of ₹ 69.67 crore (see Box 5.5).

Box 5.5: Illustrative Cases

In DIT-E, Delhi, AO allowed ₹ 43.09 crore received by **Price Stabilization Fund Scheme** for AY 10 as interest on corpus fund as deemed application u/s 11(1)(2)(i). It resulted in non levy of tax of ₹ 16.42 crore.

5.23 *The Ministry stated (May 2013) that the investment of trust funds in specified modes provided u/s 11(5) is not restricted to only income accumulation part but extends to all funds (including corpus) of the trust. Therefore, mode of investment is already specified. In the illustrated case the assessee did not receive any sum of ₹ 4308.56 lakh, the said amount was only the interest accrued on the corpus fund for the relevant financial year and the same has been given in notes to accounts. This amount has been kept with the Department of Commerce along with corpus fund. The whole amount was not actually released to the trust as there was no requirement.*

5.24 *The reply of the Ministry is not acceptable as interest earned was deposited in Public Account of India and was treated as part of income not received during the year. In the computation of taxable income this amount was claimed as deemed application u/s 11 (1) (2) (i). The Ministry may examine facts of both cases and take suitable remedial action.*

There is no enabling provision in Act to deduct TDS in case of Trusts. Therefore, AOs allowed expenditure incurred by Trusts in seven cases, without deducting TDS which involved tax effect of ₹ 9.49 crore.

No provision in Act to deduct tax at source in case of Trusts

5.25 There is no enabling provision in Act to disallow the expenses on which TDS has not been deducted by Trusts similar to the section 40(a)(ia), applicable for the entities computing income under Chapter IV.

5.26 In the absence of any TDS on such amounts, such amounts are often unnoticed at the time of scrutiny. Statutory requirements imposed on Trusts like Audit Reports in Forms 10B or 10BB have no disclosure with regard to compliance with TDS provisions. If such amounts are made to comply with TDS provisions, ITD would have a handy tool to disclose such amounts.

5.27 We noticed that in seven cases, AOs irregularly allowed expenditure incurred by Trusts without deducting TDS which involved tax effect of ₹ 9.49 crore (see Box 5.6).

Box 5.6: Illustrative Cases

In DIT-E, Hyderabad, **AP State Housing Corporation Ltd** for AY 03 to AY 07 and AY 09 did not deduct TDS on corresponding expenditure u/s 40(a)(ia), yet expenditure was not disallowed. This involved tax effect of ₹ 4.57 crore. ITD accepted the audit observation.

5.28 *The Ministry stated (May 2013) that issue raised by audit will be examined.*

5.29 *The Ministry, besides examining the cases, may take a decision, in principle, whether TDS has to be deducted by Trust or not.*

Sub sections (iiiab) and (iiiac) u/s 10(23C) of Act exempt income of any university or other educational institution/hospitals existing solely for educational/philanthropic purposes and not for purposes of profit, which is wholly or substantially financed by the Government. However, the word “substantially financed” is not defined in Act. This has resulted in according tax benefits to Trusts.

Divergent interpretation of phrase “substantially financed”

5.30 Subsection (iiiab) and (iiiac) under section 10(23C) of Act exempt income of any university or other educational institution existing solely for educational purposes and not for purposes of profit, which is wholly or “*substantially financed*” by the Government. This also applies to any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons existing solely for philanthropic purposes and not for purposes of profit.

5.31 However, the word “*substantially financed*” is not defined in Act. Section 2(18)(a) defines holding of not less than 40% of the shares of a company by the Reserve Bank as “substantially interested”.

5.32 In the following cases, AOs took divergent stand while considering percentage of expenditure financed by Government to Trust.

Charge	Assessee	AY	% of Govt contribution to total exp.	Remarks
ADIT-E, Mumbai	Sadhana Education Trust	AY 09	50.00	Disallowed by AO but allowed by CIT(A)
DCIT 2 Jalgaon	Khandesh College Education Society	AY 10	49.00	Allowed
ITO (E) -II(1) under DIT-E,	Peoples Education Society	AY 10	57.40	Allowed
DIT-E, Delhi	National Institute of Fashion Technology	AY 09	14.00	Allowed

5.33 *The Ministry stated (May 2013) that issue raised by audit will be examined.*

Section 10 and section 11 of Act are of overlapping nature. ITD in 30 cases allowed exemptions to trusts who were claiming exemption benefit simultaneously/alternatively in both sections 10(23C) and 12A in different AYs.

Overlapping of clauses in sections 11, 12 & 10 (23C) allowing exemption to Trusts

5.34 Sections 10 and section 11 of Act are of the overlapping nature. Due to such non-exclusiveness, trusts and institutions who are otherwise not eligible for exemption under section 10 are taking exemptions under section 11.

5.35 Public Accounts Committee (PAC) recommended³² removal of overlapping nature of exemptions provided in sections 11, 12 and 10(23C). The PAC had also observed in the same report that sections 10 (23C) and section 11 and 12 of the Act are being misused by private educational institutions because of its overlapping nature. The Ministry assured that suggestions of the PAC to merge the above provisions governing tax exemptions for educational institutions had been forwarded for consideration to the expert group constituted for this purpose. However, ITD has not yet brought any change in law debarring simultaneous exemption under section 10 and section 11 at the same time.

5.36 We noticed that ITD in 30 cases allowed exemptions to trusts who were claiming exemption benefit simultaneously/alternatively in both sections 10(23C) and 12A in different AYs (see Box 5.7).

Box 5.7: Illustrative Cases

a. In DIT-E, Mumbai, ITD denied exemption to **Sanskar Sarjan Education Society** for AY 09 was under section 10(23C)(iiiab) but allowed under section 11. Similarly, in two cases in Mumbai and in one case in Pune, assesseees were claiming exemption benefit simultaneously/alternatively.

CCIT Kolkata rejected assessee's application (**Sree Shwetabmar Sthanakvasi Jain**) for exemption u/s 10(23C)(vi) for AY 10 onwards. ITD allowed exemption to the assessee for AY 11 as the assessee was registered u/s 12A.

The Ministry stated (May 2013) that scope of both the exemptions under Section 10 (23C) and Sections 11 and 12, although overlapping is not absolutely identical and admissibility depends on the facts of each case. In case of Sanskar Sarjan Education Society, exemption under Section 11 was allowed because the said institution was registered u/s.12A. The rejection of application u/s 10(23C)(vi) by the CCIT does not automatically dis-entitle the Trust from exemption u/s 11. Application u/s 10(23C)(vi) can be rejected if the applicant is found to be engaged in other activities apart from education. Facts in each case will have to be examined for applicability.

5.37 *The Ministry stated (May 2013) that it is possible that approval u/s 10(23C) (which is given by CCIT) is denied in a particular case where registration is granted. This is because the requirements for registration and approval u/s 10(23C) are different. Section 10(23C) approvals are given to purely educational institutions or philanthropic hospitals and Institutions of State or National importance. The eligibility for section 10(23C) approval is, therefore, more restrictive than for registration.*

5.38 *Audit is of the view that there are several instances where an assessee solely engaged in educational activities, availed exemption u/s 11 when they could not receive approval u/s 10(23C). Therefore, it is necessary to identify the section under which approval has to be granted at the approval/registration stage itself according to the nature of charitable activities carried out by the applicants and the registration/approval has to be restricted to the relevant section only [either u/s 12AA or u/s 10(23C) of the Act].*

5.39 *The Ministry stated (July 2013) that the view of Audit does not seem to be in accordance with the provisions of Act, because there is no bar on a Trust/Institution*

³² PAC (2006-07) thirty sixth Report on CAG's AR. No 13 of 2004 on "Assessment of Private Schools, Colleges and Coaching Centres"

engaged in educational activities from getting registered u/s. 12AA and also approved u/s. 10(23C). Further, Trust is not required to apply for registration and approval u/s 10(23C) simultaneously and if it applies for section 10(23C) subsequently, the same has to be considered and cannot be denied on the sole ground that Trust is already registered u/s 12AA.

5.40 *Audit is of the view that the Ministry may clarify its stand on the assurance given to the PAC by them on the suggestions to merge provisions governing tax exemptions for educational institutions forwarded for consideration to the expert group.*

Deficiencies were noticed in Forms specified for Audit Report to be enclosed with the returns.

Deficiencies in Forms specified for Audit Report to be enclosed with the returns

5.41 We observed the following deficiencies:

- a. Form No 10B and 10BB, specified for Audit Reports u/s 12A(b) and u/s 10(23C) do not have column for nature of activities and objectives of Trust.
- b. There is no column in the Forms for year wise details of accumulations/utilization of amounts. In the absence of such information, keeping track of utilization/taxation of accumulated funds after specified period is difficult.
- c. While the Form 10BB asks for details of donations of section 115BBC, no such information was required to be given in Form 10B.
- d. The Forms are silent on the aspect of compliance with the TDS provisions.

5.42 *The Ministry stated (May 2013) that suggestions made by audit will be examined.*

Recommendations

5.43 We recommend that

- a. The Ministry may bring suitable amendment in Act to streamline the treatment of depreciation, deficit and repayment of loans.

The Ministry stated (May 2013) that the matter will be examined.

- b. The Ministry should issue suitable instructions to verify information of major donations received u/s 80G during scrutiny cases to ensure the proper accounting of donations/transaction in the accounts of donors.

The Ministry did not agree (May 2013) to issue any further instruction as cross verification is already being done by AOs during scrutiny.

Reply of the Ministry is not acceptable as illustrated cases at Box 5.4 a and c relate to scrutiny assessment involving high money value. The Ministry may reiterate instructions in this regard.

The Ministry further stated (July 2013) that the donations given or received u/s 80G are subjected to scrutiny. Once such cases are so selected, follow-up actions is taken in suitable cases.

Audit reiterates its view as cases pointed out are related to scrutiny assessment.

- c. The Ministry may bring suitable definition for the phrase “*substantially financed*” to clarify provisions of section 10(23C).

The Ministry stated (May 2013) that the matter will be examined.

- d. The Ministry may consider bringing suitable modifications in provisions for compliance with TDS provisions by Trusts and the provisions may be made for proper disclosure in the Audit Reports.

The Ministry stated (May 2013) that the matter will be examined.

- e. The Ministry may consider bringing out suitable changes in Forms to be submitted by Trusts.

The Ministry stated (May 2013) that Form ITR-7 is being notified and necessary changes, if required, shall be carried out.