

Chapter 3: Status of Action Taken Notes (ATN) of the Ministry on earlier CAG's Audit Reports and Public Accounts Committee (PAC) recommendations

Audit had conducted a Performance Audit on Exemptions to Charitable Trusts and Institutions in the year 2012 and included the findings in the Comptroller and Auditor General of India's Audit Report No. 20 of 2013 which was laid in Parliament in December 2013.

The main objective of the earlier Performance Audit was to seek assurance that registrations are given to trusts involved in charitable activities only, and exemptions are allowed to eligible Trusts. The study also sought assurance that proper monitoring mechanism exists for utilisation of accumulations and identifying inadequacies in the provisions of the Act relating to exemptions.

The Report highlighted certain lapses such as (a) grant of approval/registration without adequate documents; (b) non-inclusion of dissolution clause in the Trust Deed; (c) Irregular exemption to trusts which were not charitable in nature; (d) Delay in granting registration/ approval/notification; (e) irregular exemptions to trusts creating huge surpluses consistently; (f) irregular exemption of anonymous donations/ voluntary contributions; (g) non-monitoring of accumulations of income of trusts; (h) Irregular exemption for investment not made in specified mode; (i) non-monitoring of foreign contribution received by trusts etc.

The Public Accounts Committee (PAC) examined the report as well as the action taken by the ITD and included their observations/ recommendations in its 27th Report (16th Lok Sabha) which was presented in Parliament in December 2015. Thereafter, the Committee (2018-19), presented its 104th Report (16th Lok Sabha) on the Action Taken by the Government on observations/ recommendations of the Committee contained in its 27th Report (16th Lok Sabha) to the Parliament in July 2018.

In this chapter, Audit attempted to review action taken by the Ministry on the recommendations of the PAC based on the audit findings/ recommendations contained in the Performance Audit Report No. 20 of 2013. The recommendations of the PAC as well as Audit and the status of action taken by the Ministry thereon are as follows:

3.1 Actions taken by the Ministry on the recommendations of the PAC

3.1.1 Actions taken relating to procedural issues relating to registration and ineffective monitoring of accumulation

With regard to procedural issues relating to registration and ineffective monitoring of accumulation, the Ministry submitted¹¹ before the PAC that proposed restructuring of the Exemption Directorate would result in specialization on exemption matters with better control as well as monitoring and the introduction of web based interactive platform for applying for registration would make the whole registration/approval/notification process faster, smoother and transparent. In response, the PAC desired that the Ministry should undertake these proposed measures expeditiously. The PAC further recommended¹² that the Ministry may bring suitable amendment to the Act or evolve a suitable mechanism to ensure that firstly, trusts are allowed accumulations consistently only as exceptions and secondly, the accumulated income is applied for objectives of the Trusts/Institutions within a specified time frame.

Audit noted that the Ministry has taken the following remedial measures relating to procedural issues relating to registration and ineffective monitoring of accumulation:

- (a) The Ministry through restructuring, created a separate '*Exemption wing*' in ITD for dealing exclusively with issues relating to exemptions to charitable Trusts/Institutions from November 2014 which is headed by a Chief Commissioner of Income Tax (Exemption) and has 14 Commissioners of Income Tax (Exemption) under him. They will be in charge of registration; verification and building the data bank. They will also be in charge of the entire administration which is required to implement these provisions relating to the exemption available to the Charitable Organisations.
- (b) Online Registration/approval through ITBA system has been introduced under Sections 12AA and 80G(5) in July 2016 and 10(23C)(iv), (v), (vi) and (via) in September 2016.
- (c) e-filing of Income Tax Returns and Audit Reports by Trusts/Institutions having taxable income above the exemption limit was mandatory from AY 2013-14 onwards.
- (d) Disclosure of year-wise details of accumulations, their utilisation and investments, through appropriate columns in ITR-7 had been introduced from AY 2013-14 onwards.

¹¹ Para 6, Part II of 27th Report (16th Lok Sabha)

¹² Para 10 (ii) of 27th Report (16th Lok Sabha)

3.1.2 Actions taken by the Ministry relating to compliance issues

Audit noted that the Ministry has taken the following remedial measures considering the recommendations made by Audit¹³ with reference to assessment of charitable trusts and institutions; and inconsistencies in the Act, through amendments in the Finance Act (No.2), 2014, the Finance Act, 2016 and the Finance Act, 2017 in respect of exemptions allowed to charitable trusts and institutions:

(i) Clarification of the phrase 'Substantially financed' under Section 10(23C)

Under clause of (iiiab) and (iiiac) of Section 10(23C), educational and medical institutions are exempt from tax if such institutions are wholly and substantially financed by the Government. However, the word "substantially financed" was not defined in the Act.

After being pointed out by Audit, Section 10(23C) of the Act was amended vide Finance (No.2) Act, 2014 by inserting an Explanation below Section 10 (23C). Rule 2BBB was inserted in the Income-Tax Rules vide Notification No. 79 /2014 dated 12th December 2014 to prescribe such percentage to be 50 *per cent*.

(ii) Treatment of claims of depreciation by Trusts/Institutions

Charitable Trusts/Institutions were availing deductions on capital expenditure and at the same time, they were availing depreciation on fixed assets. This amounted to a kind of double benefit.

After being pointed out by Audit, the Income-Tax Act was amended vide Finance (No.2) Act, 2014 to provide that under Section 11 and Section 10(23C), income for the purpose of application shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as application of income under these Sections in the same or any other previous year. This amendment is effective from 1st April, 2015.

(iii) Treatment of receipts of dividend by Trusts/Institutions

Charitable Trusts/Institutions were claiming exemption on dividend income on shares and mutual funds under Sections 10(34) and 10(35) though such dividend was not applied for charitable purposes.

Section 11 of the Income-Tax Act was amended vide Finance (No.2) Act, 2014 to provide that where a trust or an institution has been granted registration for purposes of availing exemption under Section 11, and the registration is in force for a previous year, then such trust or institution cannot claim any exemption

¹³ Report No. 20 of 2013 – Exemptions to Charitable Trusts and Institutions

under any provision of Section 10 [other than that relating to exemption of agricultural income and income exempt under Section 10(23C)]. Similarly, entities which have been approved for claiming benefit of exemption under Section 10(23C) would not be entitled to claim any benefit of exemption under other provisions of Section 10 (except the exemption in respect of agricultural income).

(iv) Cancellation of registration under Section 12AA

Section 12AA(3) and 12AA(4) of the Act was amended by the Finance (No.2) Act, 2014 which provides that if the activities of Trusts/Institutions are not genuine or the activities are not being carried out in accordance with the objects of the Trusts/Institutions or the activities are being carried out in a manner that the provisions of Sections 11 and 12 of the Act do not apply to exclude either whole or any part of the income of such Trusts/Institutions due to operation of Section 13(1), then the competent authority i.e. the Pr. Commissioner or the Commissioner may by an order in writing cancel the registration of such trust or institution provided that no order under this sub-Section shall be passed unless such trust or institution has been given a reasonable opportunity of being heard.

(v) Special provisions relating to tax on 'Accreted income' of certain Trusts and Institutions

The Finance Act, 2016 had introduced a new Chapter XII-EB containing Sections 115TD to 115TF titled 'Special provisions relating to tax on accreted income of certain Trusts and Institutions'. It provides that where a Trust or Institution ceases to be a charitable organization by way of its conversion into any form which is not charitable or merges with a non-charitable entity, or transfers its assets to any trust which is non-charitable or does not transfer it to another charitable trust within a period of one year from dissolution, then the amount of net assets based on fair market value as on the date of such conversion or merger or dissolution which represents the income accreted to the trust over period of time shall be charged to additional income-tax at the Maximum Marginal Rate¹⁴.

(vi) Widening of survey under Section 133A to cover Charitable Trusts

Survey under 133A of the IT Act is an important tool with the ITD for detecting and preventing tax evasion. The ambit of survey operations, under Section 133A of the Income Tax Act, was widened to cover Charitable Trusts, vide Finance Act, 2017, to enable the Income Tax Authorities to conduct Surveys at premises where an activity for charitable purpose was being carried out.

¹⁴ The maximum marginal rate (MMR) is the rate of income tax applicable in relation to the highest slab of income

(vii) Provision to deduct tax at source in case of trusts

Audit noticed that there was no enabling provision in the Act, similar to the Section 40(a)(ia), to disallow expenses on which TDS should have been deducted but has not been deducted by trusts or after deduction, has not been paid on or before the due date of furnishing of return of income.

Section 11 and Section 10(23C) of the Income-Tax Act was amended vide Finance Act, 2018 to provide that if any payment on which tax is required to be deducted but has not been deducted or tax has been deducted but not paid within the due date of filing of return of income, then such amount shall not be considered as application of income.

(viii) Set-off of the deficit of earlier years with the current year's income

Audit had pointed out inconsistencies in allowance of carry forward of deficit in case of exempt entities and recommended that the Ministry may take a decision, in principle, whether deficit of earlier years in case of a trust was to be allowed or not to bring in uniformity.

Section 11 and Section 10(23C) was amended vide the Finance Act, 2021 to clarify that the calculation of income required to be applied or accumulated during the previous year shall be made without any set off or deduction or allowance of any excess application of any of the years preceding the previous year.

(ix) Absence of clarity in the Act regarding repayment of borrowed funds

Audit had pointed out inconsistencies in allowance of repayment of loans in cases of exempted entities and recommended that the Ministry may bring suitable amendment in the Act to bring a uniformity in allowance of repayment of loans.

Section 11 and Section 10(23C) was amended vide by the Finance Act, 2021 to clarify that application for charitable or religious purposes from any loan or borrowing, shall not be treated as application of income for charitable or religious purposes

(x) No monitoring system in respect of donations under Section 80G

Audit had pointed out that there was no internal mechanism within ITD to have control over the receipts issued by the entity having registration under Section 80G.

The Finance Act, 2020 with effect from 01.04.2021 had introduced a provision in this regard, which states that claim of the assessee for a deduction in respect of any donations made to an institution or fund to which the provision of Section 80G(5) apply, in the return of income for any assessment year filed by him, shall

be allowed on the basis of information relating to the said donation furnished by the institution or fund to the prescribed Income Tax authority or the person authorized by such authority, subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

3.2 Deficiencies pointed out in CAG's Report No. 20 of 2013 that have not been satisfactorily addressed

Audit noticed that the following deficiencies had been pointed out in our earlier performance Audit Report No. 20 of 2013; however, these were not satisfactorily addressed by the ITD. These deficiencies have been discussed in detail in the succeeding Chapter 5 and Chapter 7.

(i) Internal Audit of the Registration process

The PAC recommended¹⁵ that the process of registration/approval of the Charitable Trusts/Institutions should be brought under the purview of Internal Audit of the Department.

Audit noted during the Performance Audit that the ITD has not addressed the issue which has been illustrated in paras 7.1.3 and 7.1.4.

(ii) Ineffective monitoring of accumulation of income and its utilisation

The PAC recommended¹⁶ bringing suitable amendment to the Act or evolving a suitable mechanism to ensure that accumulated income is applied for the objectives of the Trusts/Institutions within a specified time frame. The Ministry should perform strict monitoring of Form 10 invariably in all the cases to cover all assessments.

Audit noted during the Performance Audit that the ITD has not addressed the issue which has been illustrated in paras 7.1.11 and 7.1.12.

(iii) Ineffective monitoring of receipts of foreign contribution and their utilisation

The PAC recommended¹⁷ that the Department should formulate the data sharing mechanism with the Ministry of Home Affairs (MHA) to keep a track of foreign contributions (FCs) received and their utilisation for the declared purpose. It was also recommended that a mechanism may also be developed particularly to monitor application of foreign contributions received and a clear set of guidelines in this regard be issued to all the AOs. Audit observed that desired mechanism to monitor the foreign contributions has yet to be established.

¹⁵ Para 7, Part II of 27th Report (16th Lok Sabha)

¹⁶ Para 10(ii) & (iii), Part II of 27th Report (16th Lok Sabha)

¹⁷ Para 15, Part II of 27th Report (16th Lok Sabha)

Audit noted during the Performance Audit that the ITD has not addressed the issue which has been illustrated in para 7.1.13.

(iv) Inadequacy of survey of educational trusts

The PAC desired¹⁸ that a survey of all the educational trusts be conducted in a time bound manner so as to verify whether they were misusing the provisions of 'Charitable Trusts' in the Income Tax Act considering the huge surpluses generated and accumulated by most of these trusts.

Audit noted during the Performance Audit that the ITD has not addressed the issue which has been illustrated in para 7.1.5.

(v) Absence of provision for disclosure of TDS in Audit Report

Audit had pointed out that audit reports in Forms 10B or 10BB had no disclosure with regard to TDS deducted/deductible by the trusts and the PAC recommended¹⁹ to the Ministry that appropriate provisions may be made for inclusion of such information in the Audit Reports of trusts since it would be an effective tool for greater transparency during assessment procedures.

However, Audit noticed that no provision has been made for inclusion of such information in the Audit Reports in Form 10B/10BB of trusts as pointed out by Audit.

3.3 Status of action taken by the Department and Audit comments thereon in respect of follow-up audit of 'Exemptions to Charitable Trusts and Institutions' included in Chapter VI of the Compliance Audit Report No. 9 of 2019 (Direct Taxes)

In pursuance to C&AG's Audit Report No. 20 of 2013 (Exemptions to Charitable Trusts and Institutions), the PAC inter alia expressed their concern over the serious nature of all the violations and failure of the ITD to monitor whether the trusts were fulfilling the objectives under which they have been established and also that public charitable trusts were being used to run business for profit. Further, the committee desired the office of the Comptroller & Auditor General of India to submit a report on the violations of the Public Charitable Trusts and make recommendations on how to remedy the gaps and prevent such recurrences in future. Therefore, C & AG decided to conduct a PA on Exemptions to Charitable Trusts and Institutions and accordingly data was sought for from the Department. Meanwhile, a limited follow up Audit of 'Exemptions to Charitable Trusts and Institutions' was carried out and results of the same were included in Chapter VI of the Compliance Audit Report No. 9 of 2019 (Direct Taxes).

¹⁸ Para 9, Part II of 27th Report (16th Lok Sabha)

¹⁹ Para 18 Part II of 27th Report (16th Lok Sabha)

During the current PA, Audit also verified action taken by the Department in respect of 42 cases (involving 34 assesseees) included in the above Report No. 9 of 2019, pertaining to CIT(E), Mumbai and CIT(E), Pune Charges.

The summary of status of action taken by the Department is categorized as follows:

(i) Cases where the audit observations were accepted by the Ministry

The Ministry has partially accepted audit observations in three cases and no further comments were offered to the Ministry in view of the reply. Details of the audit observation, reply of the Ministry and Audit comments thereon are given in **Appendix 3.1**.

(ii) Cases where the audit observations were not accepted by the Ministry

The Ministry did not accept the audit observations in 16 cases. Out of these cases:

- (a) In one case, no further comments was offered to the Ministry in view of the reply, mentioned in **Appendix 3.2**; and
- (b) In the remaining 15 cases, Audit did not accept the replies of the Ministry and requested to reconsider their replies/ to furnish further relevant documents to support Ministry's contention. Details of the audit observation, reply of the Ministry and Audit comments thereon are given in the **Appendix 3.3**.

(iii) Cases where no reply was furnished by the Ministry but the Department had taken/initiated remedial action or not accepted the audit observations.

The Ministry did not furnish replies to the audit observations in respect of 19 cases. However, it was noticed in the local field audit verification that the Department had either not accepted the audit observations or initiated/taken remedial action. Details of the audit observation, reply of the Ministry and Audit comments thereon are given in **Appendix 3.4**.

(iv) Cases where no reply was furnished by the Ministry and no action taken/initiated by the Department.

The Ministry did not furnish any reply and also no remedial action was initiated/taken by the Department in four cases. The gist of audit observations, current status of the cases are tabulated below:

Table: 3.1: Cases where no reply was furnished by the Ministry and no action taken/initiated by the Department.						
Sl. No.	Name of the Assessee	AY	Para no. of Report No. 9 of 2019	Gist of the audit observation	Tax Effect (₹ in crore)	Action taken by the ITD
1.	T ₂ Trust	2009-10	6.5	ITD denied exemptions under Section 11, but allowed deductions for expenditure	3.62	Reply was awaited from the Ministry. Audit noticed from field verification that no remedial action was initiated/taken by the Department.
2.	N ₅ Trust	2013-14 & 2014-15	6.5	ITD denied exemptions under Section 11, but allowed deductions for expenditure	0.95	Reply was awaited from the Ministry. Audit noticed from field verification that no remedial action was initiated/taken by the Department.
3.	T ₂ Trust	2014-15	6.5	ITD denied exemptions under Section 11, but allowed deductions for expenditure	0.37	Reply was awaited from the Ministry. Audit noticed from field verification that no remedial action was initiated/taken by the Department.
4.	T ₃ Trust	2014-15	6.5	ITD denied exemptions under Section 11, but allowed deductions for expenditure	0.34	Reply was awaited from the Ministry. Audit noticed from field verification that no remedial action was initiated/taken by the Department.

As the time limit for issuing notice under Section 148 has been revised by amending provisions²⁰ of Section 149, there is likelihood of action on these cases become time barred. Therefore, the Ministry/CBDT is requested to initiate action after verification of the facts, on priority and intimate the same to Audit. Further, the Ministry/CBDT may also take suitable steps for avoiding recurrence of such anomalies in future, as pointed-out by Audit.

²⁰ Finance Act 2021 w.e.f. 01.04.2021

