

Challenges faced by Charities in Tax Compliances

-CA Kishor Phadke

Meaning of Charity

- True meaning of charity is a mystery
- General meaning
- Charity
 - = Giving goods / money to unfortunate
 - = Almsgiving
 - = Ailing injured
 - = Generosity and helpfulness towards needy and suffering
 - = kindness to others
 - = Giving voluntarily to those in need
 - = ... and so on
- Elevated meaning of charity includes upliftment of human life / betterment of ecology, animals, plants, trees, and so on ...
- Charitable entities support task of welfare state assured by Constitution

Meaning of Charity under ITA

- Under ITA, charitable purpose is defined to include the three classic charities i.e.
 - Education
 - Medical relief
 - Removal of poverty
- To these traditional charitable objects, some more purposes are added i.e.
 - Yoga
 - Protection of environment
 - Advancement of any other object of general public utility
- Under ITA, what does not constitute charity has also been specified i.e. a business / commerce under the name of charity
- Qualitative and quantitative tests are applied to segregate a “charity” proper and “business / commerce under name of charity”, from each other
- Benefit of exemption is assured for pure charity
- And for locating pure charity, a massive procedure has been prescribed

Evolution of Charitable purpose in ITA

- Present complex process of exemption of a charity passes through many rigors i.e.
 - Bonafide objects of pure charity (without element of business / commerce)
 - Registration
 - Mapping of gross income
 - Applications of gross income for revenue expenditure for and CAPEX
 - Accumulation / carry-forward of incomes
 - Restriction of application made outside India or for a religion or caste ..
 - Restrictions on specified persons (say trustees, etc.) not to take undue benefit
 - Adherence to disallowance sections like 40A(3), etc.
 - Taxation of streams like Anonymous donations, etc. separately
 - Compliances of filing (say form-10, form-10B, form-10BB, form-9 and ITR, etc. in time)
 - Apply strictness of accretion of income in case of loss of registration u/s 115TD, ...
 -and so on

Taxation of "Charity"

- Key changes (about 15 items) from time to time are stated [separately](#)
- Mechanism (in short) is stated [separately](#)
- How to compute "income" / "revenue" is stated [separately](#)
- How to compute "Applications" is stated [separately](#)
- How to compute "Accumulations" is stated [separately](#)
- Key issues of registration are stated [separately](#)



Cognizance of section 10(23C)

- [Separate file](#) linked to show, critical differences between various related sections

Position of Charities before 5 years, and today

- In and around Pune, there exist thousands of charitable institutions (say 10,000)
- Assume that, these have been registered under BPT / MPT / Companies Act
- Now, till year 2017-18, all these entities were enjoying exemptions from ITA subject to some compliances
- It can be contended that, out of (say) 10,000 charities, about 500 of them suffered cancellation of registration or suffered taxation due to non-compliances, etc.
- New scheme of registration was introduced
- Now, as of date, majority of these trusts of have lost their registration
- Here is a RTI report which is an eye-opener

RTI

कार्यालय केन्द्रीय जन सूचना अधिकारी तथा आयकर अधिकारी ,(छूट)(मुख्या)पुणे कमरा क्रमजिल्हा तीसरी ,320, सी विंगस्वार्गट ,इमारत पीएमटी , पुणे 411037	भारत सरकार Govt. of India  सत्यमेव जयते	Office of the Central Public Information Officer & Income Tax Officer(HQ)(Exemptions), Pune Room No. 320, 3 rd Floor, C Wing, PMT Building Swargate, Pune - 411037
No.PN/CIT (E)/RTI/2023-24/ 5502		Date: 19/02/2024
Name and address of the applicant	Shri Manakehand Laxman Baheti, Harihar Apartment, 728/B, Sadashiv peth, Kumthekar Rad,Pin :411030	
Date of receipt of application	05/02/2024	
Date of order	19/02/2024	
<u>ORDER U/S 7(1) OF THE RIGHT TO INFORMATION ACT, 2005</u>		
<p>The applicant has filed an application under the Right to Information Act, 2005 which has been received in this office on 06/02/2024 from the O/o the DGIT (Inv.), Pune, for furnishing of information. The details are as under:</p>		
Sr.No	Information sought	Decision
1.	Information about 80G and 12 A approval for the period of 01/04/2022 to 31/12/2023. Please provide the following information: a) No. of applications received. b) No. of applications approved. c) No. of application rejected d) Balance pending for disposal	The data sought by the applicant in respect of 12A and 80 G application for the period of 01/04/2022 to 31/12/2023 in respect of the charge of CIT(E), Pune is as under: a) No. of applications received-8064 b) No. of application approved-1036 c) No. of applications rejected-4786 d) Balance pending for disposal-2242
<p>2. The applicant may prefer appeal under section 19 of the Right to Information Act, 2005 against this order before the First Appellate Authority i.e., Commissioner of Income Tax, (Exemptions), C wing, PMT Building, 3rd Floor, Swargate, Pune-411037, within 30 days from the receipt of this order.</p>		
 (Shripad D. Palekar)		

Thinking in retrospect ...

- One wonders as to, what is the cause of this sea-change of situation
- Change has occurred due to many reasons, some of which are -
 - Reason-1 – Crucial observations in the two landmark apex court decisions i.e. AUDA & New Nobel
 - Reason-2 – Complex drafting of new sections of ITA
 - Reason-3 – Complicated procedure of registration / re-registration
 - Reason-4 – High-tech Artificial Intelligence system introduced by CPC
 - Reason-5 – Very strict governance by I-T officials
- As a result, massive litigation has evolved in field of CHARITY
- Past years witnessed tax litigation in fields of HUF / PVT trusts / Transfer-Pricing, etc.
- Not, Charity is the Tax Litigation issue focus ...

Trapped Position

- Today, due to all these various reasons, charities are finding themselves in a

TRAP

1st Apex Court rulings ...

- On 19/10/2022, two decisions pronounced by Honorable Supreme Court
- 1st was the New Nobel decision related to section 10(23C)
- In this decision, Supreme Court observed that a charity, claiming exemption u/s 10(23C) ought to comply with the following phrase, **strictly**

"....existing solely for educational purpose and not for the purpose of profit..."
- It is observed therein that purposes little away from education violate the section
- As a result, many charities started opting for 12A registration, assuming that, this route is little easier ..

2nd Apex Court rulings ...

- 2nd decision was that of Ahmedabad Urban Development Authority
- Herein, it was provided that a charity earning mark-up / margin of 20% over its costs will lead to violation of section 2(15) i.e. charitable purpose
- Per se, 20% mark-up test is not emanating from the express language of the section
- In fact, from the section phraseology, receipts test (i.e. 20% of commercial receipts) emerges
- That too, 20% test is to be applied only for GPUs and not other non-GPU charities
- But, with mark-up test, situation has changed dramatically
- I-t officials have started applying this test to almost all situations

Complicated language of section for registration / re-registration ..

- The Multiple registration process leads to many challenges
- In the virtual real-time application procedures, many errors creep in
- Wrong selection of drop-down menus is the most common one ..
- Problems occur due to occult drafting of new sections ..
- Instead of stating the desired intent in the very same section, references and cross-references are given to some other section .. and so on ..
- For example, consider situations envisaged in various sub-clauses of section 12AB(1)(ac) .
- Many charities, fitting into clause(i) have applied for clause(vi) and vice-versa ..
- Difficult to make a choice ...

Complicated registration / re-registration as per new section..

- After availing provisional registration, when to opt for permanent registration is acute problem –
- Consider a case of a charity, which (say) exists for last ten years (say from 1/4/2010) and which has **not claimed** 12A registration under the old regime
- So, in the new regime, it should opt for sub-clause (vi)(B) ideally .. (though many have chosen wrong sub-clauses..)
- (Say), it applied for provisional registration on **20/2/22**, and which was allowed for 3 years from **1/4/22 to 31/3/25**
- Assuming that, it has rightly chosen sub-clause (vi)(B) for provisional one, and now, it wants to opt for clause (iii) for permanent, obscure wording of sub-clause (iii) to section 12A(1)(ac) comes in play, which says
 “...at least six months prior to expiry of period of provisional registration or within six months of commencement of activities, whichever is earlier”
- First deadline date will be 30/9/24 (i.e. six months prior to 31/3/25) ... yet to be reached ...
- Second deadline will be 30/9/2010 (i.e. six months from the date of commencement of activities) Already over ..
- Hence, the clause whichever earlier can never be reached ...
- This confusion can lead to selection of wrong sub-clauses, leading to further complications ..

Issue-1 – Multiple registration process

- As per the new scheme introduced in year 2021, all charities were required to undergo new registration process.
 - 1st type – Existing charities – To opt for new scheme's Re-registration straightway
 - 2nd type – A two step registration = Provisional followed by Permanent
- Entire procedure was virtual / e-driven and is real-time
- Majority of charities do not possess adequate info for ensuring this e-compliance
- Many errors creep in due to wrong selection of drop-down menus or data-entry errors ...
- ***Was this really necessary ?***
- ***What is the achievement ?***

Issue-2 – Denial of registration – Reasons cited ..

- In last 2-3 years, many reasons are **told / used** by I-T officials, for denying 12A registration ..
- Here are some interesting examples ...
 - For an educational institution, which wanted to construct a school, I-T asked for details of payments for construction, etc. final denial was for the reason that, ***tenders were not invited while awarding construction contract ...***
 - For a GPU charity which was collecting funds from MNCs and causing distribution of medicines / food, etc. in slums, despite giving all details ...final denial was for the reason that, ***PHOTOGRAPHS of actual distribution were not given ..***
- ... many such reasons are used ...
- ***Can such issues not be tested in ASSESSMENT ?***
- ***Why should 12A be denied?***

Issue-3 – Cancellation of 12A – 115TD

- As per the RTI, it appears, about 5000 charities have been denied 12A, with > **80% rejection**..
- Many of these denial cases are such charities, which were granted 12A earlier for years ..
- Not applying for new registration scheme in time, leads to 115TD (Accretion of income)
- Cancellation of 12A now, leads to invocation of section 115TD
- 115TD can be avoided only by litigation ...
- In accretion of income provisions, taxation of unearned income takes place (i.e. diff between FMV of assets and total liability of the charity)
- If such proceedings are put into service, it will impossible to meet emanating tax demands
- **I-T department may become aggressive on issuance of 115TD notices ...**

Issue-4 – Mark-up / Profit ratio of 20%

- As per the AUDA decision of Honorable apex court, a charity may find itself as pursuing an object other than “charitable purpose” if, mark-up exceeds 20% of costs
- Now, in many cases, mark-up could be a result of compelling factors like, stipulate fees fixed by authorities, etc.
- Mark-up which may evolve at the end of the year may not be envisaged at the point of charge ..
- There could be many loss-making activities for which, some income yielding activities may be taken up ..
- How to compute the mark-up for testing AUDA ratio is a challenge .. Whether overall activity or, specific activity, or group of such specific activities ..
- Whether to include passive incomes (say interest or rent) in this working or not ... another challenge
- **Practically, very difficult to apply AUDA ratio**

Issue-5 – Mark-up / Profit ratio of 20%

- Consider a hypo case of two hospitals .. (and assuming that AUDA ratio of 20% is applicable to hospitals as well..)
- 1st Hospital is (say) a posh Hospital, providing services with
 - All latest techniques,
 - top notched surgeons .. Like RUBY HALL ..
 - Which charges Rs. 5 lacs for a BYPASS surgery to patient ...
 - (and let us assume that, overall mark-up in this like RUBY HALL Hospital is 10% of costs)
- 2nd Hospital is (say) an old Hospital, providing services with
 - Old equipment and machines
 - Old surgeons (who do not take fat fees and charge minimum fees)
 - Which charges Rs. 2 lacs for a BYPASS surgery to patient
 - (and let us assume that, overall mark-up in this Old Hospital is 25%)
- As per AUDA ratio, Hospital-2 is out of eligibility of 2(15) while the Posh Hospital is eligible
- And from Patients perspective, it is Hospital-2 which has really done a charity
- **How to solve paradoxes ... Whether AUDA ratio is all-pervasive really ?**

Issue-6 – Conceptual amendments relating to actual outflow

- Now, it is provided that, Application of income of a charity will be based on actual outflow, and not “incurrence of expenditure”
- This amendment could be rationalized considering the overall scheme of Charity Taxation
- But, why should similar amendment not be done to revenue side, is confusing ..
- So, if any income has accrued, same will have to be removed on a conceptual basis for ensuring comparison of like : like
- **Occult workings follow, which may lead to errors .. and uncalled for taxation ..**

Issue-7 – Denial of exemption for untimely compliances ..

- Consider the list of compliance to be ensured ..
- File return of income in 139(1) time
- File form-10 for accumulation of income in 139(1) time and prior to filing of return ..
- File form 10B / 10BB 30 days before 139(1) date
- If time limits not adhered, CPC denies exemption automatically .. on full quantum
- Practical difficulties may result into “delays” ..
- **How much remedy could be availed in appeals can't be envisaged ... Challenge ..**

Issue-8 – Which is the point of time of commencement of activities ..

- Consider a case of GAUSHALA ...
- For housing Cows, Sheds are required to be constructed / developed
- What is the date of commencement of activity herein, is a recently cropped up issue ..
- 6 months post commencement of activity is an IMP date for many other clauses ..
- Whether housing cow in the GAUSHALA is commencement or, starting construction of GAUSHALA is commencement ... matter of litigation unfortunately ...
- **Problems for many such cases like, constructing a school-building / hospital / TEMPLE, etc.**

Issue-9 – Reporting in form 10B / 10BB ..

- These forms require large data reporting from Auditors ..
- These forms are e-filed ..
- Example-1 - Auditor may consider some donations as “Anonymous Donations” though the charity may consider otherwise ..
- Example-2 – Auditor may consider some activities of the charity as a “business / trade / commerce” and report accordingly ..though charity may consider otherwise ..
-and so on ..
- Experience suggests that, negative reporting result into (almost) automatic additions by CPC
- **Problems for many such cases like, constructing a school-building / hospital / TEMPLE, etc.**

Issue-10 – Transitional issues ..

- It has been provided that, income of a charity will be worked out without considering any set-off of earlier years excess application (i.e. deficit)
- Assume a case where, past years excess of application was due to CAPEX incurred (though remained unpaid)
- Now, if the deficit is to be considered as not eligible, corresponding payouts (actual applications) for the CAPEX provisions will have to be claimed as deductible “Applications” ..
- Similar will be case of Applications out LOAN / CORPUS ..
- All these iterations lead to massive complexity of computing taxable income finally ..
- **Mistakes in analogy / working may lead to artificial taxation without real cause ..**

Issue - 11 – Compulsion by Law

- Medical Colleges require compulsory presence of hospital, as per Medical Councils guidelines
- Per se, this activity of hospital is, away from “education”
- Whether, word “solely” is satisfied in such a case, considering SC decision in New Nobel?

Issue - 12 – Meaning of word 'Education'

- Scope of the word / term "Education" has always been a challenge
- In Lokshikshan Trust, the term "education" was deliberated, and understood in a narrower sense
- In New Noble, still narrower meaning is aired
- Many challenges arise ,, here is an example ...
- Till yester-years, Trust involved in staging play on the life of Shivaji Maharaj, was understood as "educational pursuit" ... but, not any more
- ***Just because, some noble thoughts are not in STUDY-BOOKS, can be not education?***
- ***Whether such activities be covered under the definition of EDUCATION?***

Issue - 13 – Ancillary Objects

- Large scale confusion prevails presently in construing, scope of the “Objects” in Trust deed
- In one case, Trust deed had an object that ‘Trust will run a hospital’.
- Trust started construction of hospital
- CIT(E) rejected registration because construction activities are not in the trust deed
- ***Whether running a hospital possible without constructing it?***
- ***Is it plausible to pin-point each and every object in smallest form, to be stated in Trust deed ?***

Issue - 14 – Violation in other laws

- Various other laws such as BPT, Registration Act, etc, are applicable to Trust when it comes to some real estate transaction
- In one case, a Trust raised loan from trustee ..
- In other case, took the school building on a abysmally low rent from it's Trustee for 30 years period
- Assume, in both cases, Charity Commissioner's approval remained to be availed ..
- **Are these not curable defects ?**
- **Whether such apparent breaches should lead to denial of 12A?**

Issue - 15 – Power of PCIT(C) to cancel 12A

- Consider a peculiar case ... where, a search took place in case of a trust
- Jurisdiction gets transferred to Central Circle by CIT(E) through 127 order, and then, PCIT(CC) assumed powers and cancelled 12A
- Issue arises as to who can transfer the 12A jurisdiction .. Whether CIT(E) or PCIT-CC
- Settled proposition that only a senior officer can transfer the jurisdiction to his subordinate
- If 12A jurisdiction is to be transferred, then, as per principles of hierarchical protocol, an authority senior to the CIT(E) and PCIT (Central) ought to have transferred the said 12A jurisdiction.
- **Can 12A jurisdiction be automatically transferred vide a 127 order**

Challenges

- For doing a yeomen activity of **without profit pursuit**, massive compliances have to be ensured ..
- For getting funds / recognitions / CSR eligibility / 80G compulsions, 12A / 10(23C) becomes MUST
- Threat always exists that, there will be 12A denial / 12A cancellation / Additions / Special Taxation u/s 115BBI / 115TD, etc.
- Hence ...

.... TRAP CONTINUES ...

- **Prudent professionals (like those present in this August House today), can mitigate agonies**
- **Challenge for all of us ...**