DTRC – Pune Branch of ICAI

TAX ISSUES IN TRUSTS

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May 21, 2016

CONTENTS

Understanding Trusts

What is “Trust”?

1. **Trust** comes into existence when properties are settled upon a person for the benefit of another.

2. **Indian Trusts Act 1882** – **Section 3**: Trust:

   a) An **obligation**;

   b) annexed to the **ownership of property**; and

   c) arising out of **confidence reposed** in; or

   d) accepted by the **owner**, or declared or accepted by him,

   e) for the **benefit of another**, or

   f) of **another and the owner**.

Constituents of Trust

1. **Author or Settlor of the Trust** – the person / entity reposing or declaring the confidence and settling property upon another person / entity.
   - There can be more than one Settlor.
2. **Trustee(s)** – the person(s) who accepts such confidence and the property with an obligation to hold it for another person / entity.
   - There is no legal bar on the number of Trustees.
   - Author may lay down the maximum / minimum number of trustees, scheme of succession of office of trustee, appointment, retirement and removal.
3. **Beneficiary** – the person for whose benefit the confidence and property is accepted by the trustee.
   - Public Charitable Trust to be settled for the benefit of general public at large i.e. the beneficiaries who cannot be ascertained.
4. **Lawful Purpose:** If the creation of the trust is for unlawful purpose, the trust is void.

Constituents of Trust

5. **Trust Property** – subject matter of the Trust, which is eventually transferable to the beneficiary.
   - Settlor should be the **legal owner** of the property which is being settled.
   - **Not** mere **beneficial interest** in property.
   - Trust Property must be **legally transferrable** to the trustee. Power of disposition over property.
   - The property should be **clearly identifiable**.
   - **Transfer** of Property to the Trustees.
   - The Settlor has to **di-vest** ownership and all beneficial interest in the property.
6. **Instrument of Trust** – instrument declaring the Trust.
   - Formal deed or any other writing is <u>**not required**</u> though it is advisable to execute a written trust deed.
   - The objects and the purpose for creation of trust should be unambiguously stated.

Legal Attributes

1. **Settlor / Grantor - Persons eligible to create trusts (Section 7)**:
   a) Every person who is **competent to contract**;
   b) With the permission of a principal Civil Court of original jurisdiction by or on behalf of a minor.

2. **Persons eligible to act as Trustee (Section 10):**
   a) Every person capable of holding property;
   b) Where the trust involves **exercise of discretion**, trustee must be competent to contract.
      - Trustee of Public Charitable Trust should be competent to contract.
   c) A corporation may act as trustee. Objects in the MOA should permit.
   d) Infant / Minor can act as a trustee, where exercise of discretion is not required.
   e) Minor cannot be a trustee of a public trust.
   f) Beneficiary can be a trustee as well – conflict issues may arise.

Legal Attributes

3. **Persons eligible to be beneficiaries (Section 9)**:

    a) Every person capable of holding property.

    b) A company could be a beneficiary.

    c) Private trusts should have ascertainable beneficiaries. Unborn children could also be beneficiaries.

Legal Attributes

4. **Trust only for lawful purposes**. Trust for **unlawful purpose** if:
   a) It is forbidden by law;
   b) Is of such nature that if permitted would defeat the provisions of law;
   c) Is fraudulent;
   d) Involves or implies injury to person or property of another;
   e) Is opposed to public policy.
5. **Property of the trust**: Not future property. Only a property or interest and property which the settlor can transfer.

6. **Rule against Perpetuity:** Public charitable trusts could be perpetual. Private Trusts, governed by Indian Trust Act, 1882 are subject to the Perpetuities and Accumulations Act, 1964.
   - Future interest must vest during the life or lives of beneficiaries at the time interest in property is transferred + 18 years.

Multiple Relationships / Capacities

1. **Between Settlor and Trustee**: **Reposing** confidence and **accepting** confidence. Not based on consideration.

2. **Between Trustee and Beneficiaries**: **Fiduciary** – trustee is only a **(legal) owner** and possessor of trust property. No right of beneficial enjoyment. Trustee must act in good faith.

3. **Between Trustee and third parties**: Trustee exercises all rights of ownership.

4. **Three in One**! A person may **not** act in all three capacities viz. as Settlor, as Trustee and as beneficiary.

   - Author of the Trust may be a Trustee of that Trust as well as a Beneficiary of the same Trust.

Types of Trust

1. **Public Charitable Trust**: Beneficiaries are **public** (public at large or class of persons) and the purpose is charitable.
2. **Private Trust**: Beneficiaries are **individuals or other entities**, ascertained or ascertainable. Purpose is specific to the settlor.
3. **Revocable Trust**: Settlor retains a **right to re-transfer**, directly or indirectly, the whole or any part of the income or property settled in trust.
4. **Irrevocable Trust:** Once the Settlor settles the property in trust, it is irrevocable during the **lifetime of the beneficiary**.

Types of Trust

5. **Specific / Determinate Trust**: Private trust where the **beneficiaries are known** and their **share in the income** of the trust is **known or determinate**.
6. **Indeterminate / Discretionary Trust**: Private or Public Trust, where the **beneficiaries are unknown** or the **share of the beneficiaries** is either indeterminate or left to the discretion of the trustee.

7. **Express Trust**: When an instrument is executed defining the trustee(s) and their powers and beneficiaries and the extent of their benefits.
8. **Implied Trusts**: Trust to be **inferred** from the instrument or conduct of the parties.
9. **Constructive Trust**: Arises by operation of law - Sec 86 to 93 of the Indian Trust Act.

Types of Trust

10. **Oral Trust**: A trust created by oral declaration. Trust is not declared by a duly executed instrument in writing.
11. **Written Trust**: A trust created by written trust instrument signed both by the settlor and the trustees.

12. **On-shore Trust**: the Indian Trusts Act, 1882 is applicable.
13. **Off-shore Trust**: Trust laws of foreign jurisdiction are applicable.

14. **Inter Vivos Trust :** Trust created during the life of the Settlor / Grantor.
15. **Testamentary / Will Trust**: Trust created by the will of the decedent.

Objectives of Private Trust

1. **Employees Welfare Trusts**: Gratuity, Superannuation, Provident Fund etc.
2. **Specific objectives of Settlor**: Trust for the benefit of minors, disabled, to overcome possibility of misuse of trust property by persons having influence of beneficiaries.
3. **To secure** against attachment of property by creditors.
4. To reduce / defer **tax incidence**.
5. To insulate against **estate duty / inheritance tax**.

Taxation of Private Trusts

Status of Trust – Income Tax Act

1. Trust itself is **not a "person"**.
2. Trust has elements of "contract" and "legal person".
3. **Section 160(1) – Clause (iv) and (v):** Trustee is a representative assessee in respect of income a trustee receives or is entitled to receive on behalf or for the benefit of any person.
4. **Section 161**: **Liability of representative assessee:**
   a) Trustee subject to the **<u>same duties, responsibilities and liabilities</u>**.
   b) Legal presumption as if the income were beneficially received by the Trustee.
   c) Trustee **liable to assessment in his own name** in respect of above income.
   d) Deemed to be assessment only in representative capacity.
   e) Tax levied and recovered from the Trustee **<u>in like manner and to the same extent</u>** as it would be leviable and recoverable from the person represented by him.

Status of Trust – Income Tax Act

a) **Nizam Trust Case:** CWT vs Trustees of H.E.H. Nizam's Family (Remainer Wealth) Trust (1977) 108 ITR 555 (SC):

b) **Direct assessment** on the beneficiary in respect of his interest in the Trust. Right of Revenue is unimpaired.

c) The beneficiaries would always be assessable in respect of his interest in the Trust Properties, since such interest belongs to him.

d) Revenue has following modes of assessments:

   a) **Assess beneficiaries** interest in the trust properties in the **hands of the Trustee** in a representative capacity;

   b) **Assess beneficiaries** interest in trust properties **directly** in his hand.

   c) Where the beneficiaries are more than one, and their shares are indeterminate or unknown, the trustee would be assessable in respect of **total beneficial interest** in the trust properties.

   d) It is not possible to make direct assessment on the beneficiaries where their shares are indeterminate or unknown. The beneficial interest is treated as if it belonged to one individual beneficiary and the assessment is made on the Trustee.

Status of Trust – Income Tax Act

In the like manner and to the same extent:

a) There would be **as many assessments on the trustee** as there are beneficiaries with determinate or known shares;

b) For the sake of convenience, there may be only one assessment order specifying **separately the tax** due in respect of wealth / income-tax of each beneficiary.

c) The assessment of the trustee would have to be made in the **same status** as that of the beneficiary whose interest is sought to be taxed in the hands of the trustee.

d) The amount of tax payable by the trustee would be the same as that payable by each beneficiary in respect of his beneficiary interest, if were assessed directly.

e) Recognized and held by SC in N.V. Shanmugham & Co. vs CIT [(1971) 81 ITR 310.

Law laid down by the SC

1. **Trustee status same as the Status of the beneficiary.**
2. If the beneficiary is an “individual”, the status in which his share of income is to be assessed in the hands of the Trustee would also be that of an “individual”.
3. **“Individual”** may a group of persons forming a unit.
4. If there are **two beneficiaries**, one being individual and another HUF:
   a) The trustee would be liable to tax with respect to the share of individual beneficiary in the status of “individual”;
   b) The trustee would be liable to tax with respect to the share of HUF beneficiary in the status of “HUF”.
   c) If the beneficiaries also have their **independent source** of income, the trustee would have to consider the said income for computing the tax liability of the beneficiaries.
   d) The trustee would be liable for the **composite tax determined**.
5. Reference to Status of private discretionary trust as that of an ‘individual’ **– CBDT Circular 6/2012 dated 3-8-2012.**

Is Trust an Association of Person?

1. **Supreme Court in the case of Indira Balkrishna: [1960] 39 ITR 546**

   - The chief characteristic of an AOP is that **a group of persons must be associated in a common endeavour for producing taxable income.**
   - In the case of a trust, neither the trustees nor the beneficiaries satisfy the said basic criterion.

2. Even in a case of Section 164, the Trust cannot be assessed as an AOP.

   - (1995) 211 ITR 575 (Guj.); (1993) 201 ITR 989 (Cal.); (2004) 271 ITR 159.

Is Trust an Association of Person?

1. **Delhi High Court in the case of S.A.E. Head Office Monthly Paid Employees Welfare Trust: (2004) 192 CTR 70**

   - The trustee or beneficiary could not be considered as having come together for earning income.
   - The beneficiaries did not set up the trust.
   - The trustees derive their authority under the terms of the deed of trust. They are merely in receipt of the income.
   - The fact that the beneficiaries or the trustees being representative assessees are more than one, cannot lead to a conclusion that they constitute an AOP.
   - In absence of element of volition on the part of either the trustees or the beneficiaries, it cannot be considered to be an AOP.
   - **They have not joined of their own volition in a common effort or endeavour to produce income.**

Is Trust an Association of Person?

CIT vs. Marsons Beneficiary Trust and Other cases (1991) 188 ITR 224 (Bom):

a) Trustees are not authorised to carry on business under the terms of a deed of trust;

b) Trustees have not come together with the object of carrying on any business;

c) Trustees derive their authority to carry on business, not from the beneficiaries, but from the terms of the deed of trust.

d) The beneficiaries are mere recipients of income earned by the trust.

e) Beneficiaries have not come together for a common purpose.

f) Beneficiaries cannot be considered as AOP or BOI.

g) Accordingly, Trustees cannot be assessed as AOP even if they carry on business.

Maximum Marginal Rate ("MMR")

1. **Section 164 - Indeterminate Trust:**
   a) Where any income is liable to be assessed in the hands of Trustee;
   b) Any part of the income is not specifically receivable on behalf or for the benefit of any one person;
   c) Where the individual shares of the persons on whose behalf or whose benefit such income or such part thereof is receivable **are indeterminate or unknown**;
   d) Tax shall be charged on the relevant income at MMR.
2. Only the **"relevant income"** would be subject to MMR.
3. Whole of the income of **Determinate Trust** would be liable to tax at MMR where any income of the Trust consists of profits and gains of business (except Testamentary Will meeting specified conditions).

Maximum Marginal Rate ("MMR") - Exceptions

a) **Non taxable threshold:** If **none of the beneficiaries** has any other income chargeable under the Act exceeding the maximum amount not chargeable to tax.

b) **Testamentary Trust:** Relevant income or part thereof is receivable under a Trust declared by any person by Will and such Trust is the **only trust** so declared by him.

c) **Grand-fathered non-Testamentary Trust**: Income receivable under a Trust created **before 1st March, 1970** by a non-Testamentary instrument and the AO is satisfied that the Trust was **created bonafide** exclusively:

   i. for the benefit of the relatives of the Settlor; or

   ii. where the Settlor is an HUF, exclusively for the benefit of the members of such family

   iii. In circumstances where such relatives or members were **mainly dependent** on the settlor for their support and maintenance.

d) **Employee Welfare Trusts**: The relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund; pension fund or any other fund created bona fide by a person carrying on business or profession exclusively for the persons employed in such business or profession.

e) **Exceptions**: Relevant Income would be liable to tax as an AOP.

Discretionary Trust

Law settled by the **Supreme Court in the case of Estate of Late HMM Vikramsinhji of Gondal: Civil Appeal No. 2312 of 2007**

a) Once a trust settled/ created as a discretionary trust with powers to the trustees to distribute income of trust to the beneficiaries, even if power not exercised by the trustees for several years, the trust would still be treated as a discretionary trust.

b) Even if the trust deed mentioned that if the trustee does not exercise his powers in distributing the income then the trust income will be accrued and be paid to the beneficiaries, it would still be treated as a discretionary trust and not as specific one.

Revocable Trust

1. **Section 60 – Transfer of income where is no transfer of assets** – income **always** to be assessed in the hands of the Settlor.
2. **Revocable Trust: Section 61** – **All income** arising to any person by virtue of a **revocable transfer of assets** shall be chargeable to income-tax as the income of the Settlor and shall be included in his total income.
3. **Section 62** – Provisions of section 61 not to apply:
   - If transfer by way of trust which is irrevocable during the lifetime of the beneficiary.
4. **Section 63** – Definition of "transfer" and "revocable transfer"
   a. **Revocable Transfer** – contains provision for the re-transfer directly or indirectly of the **whole or any part of the income or assets** to the transferor; or

   b. gives a right to the transferor to **re-assume power directly or indirectly** over the whole or any part of the income or assets.

   Transfer – Includes any settlement, trust, covenant, agreement or arrangement.

Revocable Trust - ITAT Delhi in the case of MP Jaipuria (HUF): 44 ITD 728

a) Section 63 does not contemplate mere possibility of the property/income going back to the transferor but the **reservation or provision** of a definite right to retransfer or reassume as the original transferor.

b) No provision or reservation in the trust deed giving the transferor a right to reassume power directly or indirectly over the whole or any part of the income or assets nor for their retransfer to him.

c) Re-transfer to the settlor cannot be assumed because the settlor is a shareholder or director of the company.

d) No specific or definite provision in the deed giving the transferor a right to reassume power or retransfer to the same effect reserved by the transferor.

e) Settlor not included as beneficiary but only a shareholder or director of the companies having no definite right.

f) Intention of the settlor of not intending any interest in the trust further affirms no retransfer or re-assumption to the original settlor.

Section 56(2)(vii)

1. In the context of trust, **three tier evaluation**:
   - **a) Applicability**: Only to individual or HUF; not applicable to other persons.
   - **b) "Receives"** any cash, immovable property or movable property:
     - In what capacity "property" is to be received;
     - At what point the 'property" is received.
   - **c) Without consideration** or without adequate consideration.
2. **"Individual"** must be one who is capable of having a relative, who are natural persons.
3. **Mumbai ITAT in the case of Ashok C Pratap: [2012] 23 Taxmann 347** - Amount received by the taxpayer in pursuance of dissolution of Trust in the capacity of beneficiary and could not be termed to be received 'without consideration'.

Charitable Purpose

Charity – Evolution & Growth

1. Ancient Indian society based upon the concept of philanthropy. Religious beliefs and practices anchor the roots of charity in India. Voluntary organizations actively engaged in relief since medieval era.

2. The word ***"charity"*** entered English Language through French word ***"charite"*** derived from the Latin word ***"caritas"*** or ***"carus"*** meaning generous love, dear or beloved. Was in use as a Roman Christian name.

3. The English name "charity" came into use among the Puritans post Protestant Reformation.

4. Merriam Webster Dictionary defines ***"charity"*** as –

   - benevolent goodwill towards or love for humanity
   - generosity or helpfulness especially towards the needy; aid given to those in need
   - an institution engaged in relief of the poor

Charity – Vehicles / Legal Constitution

5. Legal recognition to voluntary organizations vide –
   - Societies Registration Act 1860
   - Religious Endowments Act 1863
   - Indian Trusts Act 1882
   - Charitable Endowments Act 1890
   - Charitable & Religious Trusts Act 1920
   - Bombay Public Trusts Act 1950

Charity vs. Profit Motive

1. Presence of profit motive not an essential factor even for a business activity.

2. **Supreme Court in the case of P Krishna Menon: (1959) 35 ITR 48** - An activity would not cease to be a vocation or business on account of the fact that the ultimate objective of the activity was not to earn profit. A business may be carried on a no profit-no loss basis.

3. "**Eleemosynary**" not essential to constitute "charity".

4. **Affirmed by the Privy Council In Re, The Trustees of The Tribune (1939) 7 ITR 415** – Eleemosynary element not essentially present in any purpose of general public utility and its absence would not alter the character of the charitable object.

Charitable Purpose

1. **Indian Income-tax Act, 1922** – Section 4(3)(i) –"**Charitable purpose**" includes relief of the poor, education, medical relief and the advancement of any other object of general public utility.
2. **Income-tax Act, 1961** – Section 2(15): "**Charitable purpose**" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility ***not involving the carrying on of any activity for profit***.
3. **Finance Act 1983 w.e.f. 1-4-1984** omitted the words ***"not involving the carrying on of any activity for profit"***.
4. Definition broadened –
   a. **Finance (No. 2) Act, 2009, w.r.e.f. 1-4-2009 added** ***"Preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest"***
   b. **Finance Act, 2015 w.e.f. 1-4-2016 added** the word ***"yoga"***.

Charitable Purpose

5. **Finance Act, 2008 w.e.f. 1-4-2009** added first Proviso ***"advancement of any other object of general public utility"*** shall not be a charitable purpose, if it involves the carrying on of –

   a. any activity in the nature of trade, commerce or business, or

   b. 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.

6. **Finance Act, 2010 w.r.e.f. 1-4-2009** inserted second Proviso : If the aggregate value of receipts is **Rs 10 lakhs or less** in the previous year.

7. **Finance Act, 2011 w.e.f. 1-4-2012** substituted **Rs 25 lakhs** for Rs 10 lakhs.

8. **Finance Act, 2015** substituted the first and second proviso with a new proviso w.e.f. 1-4-2016. Aggregate receipts not to exceed **20% of total receipts** of that previous year.

Judicial Precedents / Circulars

1. ***"Not involving the carrying on of any activity for profit"*** by the SC in **Sole Trustee, Lok Shikshana Trust: 1976 AIR 10 -** If the profits feed a charitable purpose, under the terms of the trust, the mere fact that the activities of the trust yield profit will not alter the charitable character of the trust.

2. ***"Object of general public utility"*** interpreted by the **SC in Andhra Chamber of Commerce: 1965 AIR 1281** –
   - Includes all objects promoting the **welfare of the general public**.
   - Purpose still charitable even if public welfare intended to be served includes steps **to urge or oppose legislation affecting trade**, commerce or manufacture.
   - <u>Primary purpose of advancement of objects of general public utility remains charitable even on an incidental entry into the political domain for achieving that purpose</u>

3. **CBDT Circular No. 11/2008 dated 19-12-2008** – Proviso not applicable to <u>**first three limbs**</u> of the definition, i.e., relief of the poor, education or medical relief;

Judicial Precedents / Circulars

4. **Delhi High Court in the case of M/s GS1 India: (2013)-TIOL-772-HC-Del-IT:** Amendments made to the definition of 'charitable purpose' u/s 2(15) of the Act vide the Finance Act, 2008 do not disqualify any residual category (general public utility) charitable entity from conducting business activity **intrinsically connected with the charitable activity** and the same does not deny tax exempt status.

5. ***"Promotion of sports and games"*** is "charitable purpose" vide **CBDT Circular No. 395 dated 24-9-1984.**

6. Travelling, though enhances knowledge, is not 'education' for the purposes of S.2(15)- **Sole Trustee, Lok Shikshana Trust: 1976 AIR 10 (SC).**

7. **"Relief of the poor"** to encompass wide range of objects for the welfare of economically/socially disadvantaged or needy and entities with the said object eligible for exemption even if they incidentally carry on a commercial activity.

Taxation of Charitable Trusts

Income of Charitable Trust

1. **Sec 2(24)(iia):** Income includes **Voluntary contributions** received by a trust created **wholly or partly** for charitable or religious purpose and other specified institutions.
2. **Sec 12(1):** Voluntary contributions received by a trust created **wholly** for charitable or religious purposes **deemed to be income derived** from property held under trust **for the purposes of section 11 of the Act**.
3. **Sec 11(1)(a)**: Exemption to the extent income derived from property held under trust **wholly** for charitable or religious purposes **is applied to charitable or religious purposes in India**.
4. **Sec 11(1)(a): Accumulation / setting apart of income:** Not to exceed 15% of the **income*** derived from property held under trust **wholly** for charitable or religious purposes.
   - ❖Voluntary contributions referred in Sec 12 shall be deemed to be part of income – Explanation u/s 11(1).
   - ❖Blanket exemption qua 15% of gross receipts as per second part of section 11(1)(a) of the Act. **– ALN Rao Charitable Trust: [1995] 216 ITR 697 (SC)**

No other exemption u/s 10 – Sec 11(7)

1. Where a trust or institution has been granted registration u/s 12AA(1)(b) or has obtained registration u/s 12A; and
2. The registration is in force for any previous year, then,
3. Nothing contained in Section 10 shall operate to exclude any income derived from property held under trust from the total income of the person in receipt thereof for that previous year.
4. Exception : Income under Section 10(1) and 10(23C).

Anonymous Donations – Section 115BBC

1. **Anonymous donations** : Voluntary contribution u/s 2(24)(11a) where the recipient does not maintain a record of the identity indicating the name and address of the person making the contribution and other prescribed particulars.
2. Provisions of section 115BBC(1) **<u>not to apply</u>** to anonymous donations received and applied by **<u>trust or institution created wholly for religious purposes</u>** – **Section 115BBC(2)**
3. Provisions of Sec 115BBC(1) **<u>not to apply</u>** also to any trust created or institution created or established wholly for religious and charitable purposes **other than** any anonymous donation made with specific direction that **Such donation** is
   - For any university or other educational institution;
   - For any hospital;
   - For other medical institution

   run by such trust or institution.

Anonymous Donations – Section 115BBC

Tax payable would be the **<u>aggregate of</u>** -

a) 30% of the aggregate of anonymous donations in excess of (higher of) 5% of the total donations or Rs.1 lakh, and

b) Income-tax chargeable on total income excluding the aggregate of anonymous donations received in excess of 5% of total donations or Rs.1 lakh, as the case may be.

Conversion of Trust to Non-Charitable Organization

1. **Chapter XII-EB:** Sections **115TD, 115TE and 115TF** inserted by the **Finance Act, 2016, w.e.f. 1-6-2016**

2. **Accreted Income** = FMV of Assets – FMV liabilities, as on specified date, as per prescribed valuation method.

3. Accreted income of a Trust/Institution registered u/s 12AA **chargeable to tax at MMR** in addition to income-tax on total income of Trust, in the following cases-

   (a) **Conversion** of trust/institution in any form ineligible u/s 12AA

   (b) **Merger** of trust/institution in any form ineligible u/s 12AA

   (c) **Trust/institution, upon dissolution,** fails to transfer assets to exempt entities u/s 12AA and 10(23C)(iv), (v), (vi) & (via) within 12 months of dissolution

Conversion of Trust to Non-Charitable Organization

4. **Assets not forming part of Accreted Income – Proviso to section 115TD**

   a. Asset acquired by Trust/Institution out of **agricultural income**

   b. Asset acquired by Trust/Institution before registration u/s 12AA, provided exemption u/s (s) 11/12 was not provided during that period

5. **Events triggering conversion of Trust/Institution** –

   a. Registration granted u/s 12AA cancelled;

   b. Adoption/modification of objects not conforming to conditions of registration and fresh registration u/s 12AA not applied for/rejected

Conversion of Trust to Non-Charitable Organization

6. **Tax on Accreted Income** to be paid **within 14 days from –**
   a. No appeal filed – date on which limitation period for filing appeal before ITAT against order cancelling registration expires, ***or***
   b. Date on which order in any appeal confirming cancellation of registration is received by the Trust/Institution, ***or***
   c. Date of merger, ***or***
   d. Date of expiry of 12 month period, in case of dissolution.
7. Amendment apparently owing to the tax litigation of Escorts Ltd. on conversion of society into a corporate body. **Ref – ITAT Delhi in Escorts Ltd.: 104 ITD 427.**

Accrual or Receipt Method?

1. **Sec 11** refers to **"income derived"** from property held under trust, may comprise of **income received** or **income accrued**.
2. **Shortfall Amount** = 85% of income derived during the year ***less*** Income applied to charitable or religious purposes in India falls short.
3. **Two-fold reasons**:
   i. Whole or any part of the income has not been received during the year;
   ii. Any other reason.
4. **Deemed to be income applied** during the previous year in which it was derived, optionally:
   - If income to the extent of shortfall amount is applied in the previous year in which the income is received or during the immediate following year;
   - If income to the extent of shortfall amount is applied in the immediately following previous year following the previous year in which the income was derived.
5. **Option** in writing to be exercised before filing the return of income u/s 139(1).
6. Double count is also removed.

Voluntary contribution towards Corpus

1. **Sec 11(1)(d): Corpus Contributions:** Exemption for income in the form of voluntary contributions made with specific direction that they shall form part of **corpus** of the trust or institution carved out.
2. **Sec 12(1)**: Voluntary Contributions - not being contributions with specific direction that they shall form part of **corpus** of the trust or institution.

Carry forward of excess expenditure over income for set-off

a. Income of the trust to be arrived at on the basis of commercial principles – **CBDT Circular No. 5P(LXX-6) dated 19-6-2008.**

b. Application in excess of income treated at par with losses.

c. Bombay High Court in the case of Institute of Banking Personnel Selection: (2003) 264 ITR 110 – Excess of expenditure in the earlier years can be adjusted against the income of the subsequent year and such adjustment would be treated as application of income in subsequent year for charitable purposes.

d. Application only of real income. If a portion of the income has been taken away by way of income-tax deducted at source, that portion is not available to the assessee for application or accumulation – **Jayashree Charity Trust: (1986) 159 280 (Cal.)**

Application outside India - Sec 11(1)(c)

1. Foreign university imparting education in India eligible for exemption u/s 10(23C) – **Oxford University Press: (2001) 247 ITR 658 (SC)**

2. Incumbent to impart education in India for claiming exemption u/s 10(23C)(vi) of the Act. The "non-profit" qualification to be tested against Indian activities – **American Hotel & Lodging Association Educational Institute: (2008) 170 Taxman 306 (SC)**

3. Exemption of income to the extent applied for charitable purposes outside India.

4. Scope only for a Trust created for charitable purposes. Not for religious purposes.

5. Trusts created on or after 1st April, 1952 which tends to promote **international welfare in which India is interested**.

6. **Board**, by general or specific order, has directed that income derived from property held in trust shall not be included in the total income of the person in receipt of such income.

Accumulation or Setting Apart – Sec 11(2)

1. **Accumulation / Setting Apart = Shortfall Amount** *less* **Deemed to be income applied**.
2. Statement to be furnished to the AO (Form 10), specifying the **Purpose** and the **Period**, not **exceeding 5 years**.
3. Statement to be furnished on or before the due date for furnishing the return u/s 139(1).
4. 5 years to exclude period covered by an order or injunction of any court.
5. Investment or deposit to be in forms or modes specified in Sec 11(5).
6. The word “applied” covers not only amounts spent but also the amount irretrievably earmarked and allocated for future spending – **Radhaswami Satsang Sabha: (1954) 25 ITR 472.**
7. **Change of Purpose**: Application to AO. Allow to allow alteration to any other charitable or religious purpose in conformity with the objects of the trust. Sec 11(3A).

Donation to another Trust

1. Donation by one charitable trust to another for utilisation by the donee trust towards its charitable objects is application of income in the hands of the donor trust, and the donor will not lose exemption u/s 11 merely because the donee trust did not apply the donations towards the charitable purposes during the year of receipt itself – **CBDT Instruction No. 1132 dated 5-1-1981**

2. Donation by a charitable and religious trust to another trust is application of income u/s 11(1)(a) - **Shri Ram Memorial Foundation: (2004) 269 ITR 35 (Del HC).** Affirmed by the **Delhi High Court in Hamdard Laboratories India: WP 5711/2013 dt. 18.09.2015.**

3. **Explanation u/s 11(2) : No application of income where:**

   a) Amount is credited or paid out to another Trust or Institution registered u/s 12AA;

   b) Out of accumulation or setting apart of income;

   c) Either during the period of accumulation or thereafter.

4. **Alteration of purpose u/s 11(3A)**: AO not to allow payment or credit to any other trust or institution **<u>except in the event of dissolution of the trust</u>**.

Capital Expenditure – whether application?

1. As far as the objects of the trust are concerned, the application of the amount can be for revenue or **capital purpose**: **Kannika Parameswari Devasthanam and Charities [1982] 133 ITR 779**

2. **Sec 11(1A):** Capital gains arising from transfer of property held under trust **deemed to be applied** for charitable/religious purposes if whole of the net consideration utilized in acquiring new capital asset.

Capital Expenditure – whether application?

3. **Kerala High Court in Lissie Medical Institutions: (2012) 348 ITR 344** and **Delhi High Court in Charanjiv Charitable Trust: (2014) 267 CTR 305:** Held that if the cost of the asset has been allowed as deduction by way of application of income then depreciation on the same asset cannot be allowed in the computation of the income of the trust.

4. **Sec 11(6)**: Where any income is required to be applied or accumulated or set apart, then for such purposes income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, <u>**acquisition of which has been claimed as an application of income under this section in the same or any other previous year**</u>.

Accumulation or Setting Apart – Deemed Income

Sec 11(3): Deemed income, if

1. Applied to purposes other than charitable or religious purposes.
2. Ceases to be accumulated or set apart for application to charitable or religious purposes.
3. Ceases to be invested or deposited in modes or forms in Sec 11(5).
4. Is not utilized for the purpose as per Statement furnished to AO during the **period** specified in the Statement furnished to AO lapses.
5. Is credited or paid to another Trust or Institution registered u/s 12AA.

Income of Business Undertaking – Sec 11(4)

1. Property held under trust includes a business undertaking so held.
2. May claim income of any undertaking shall not be included in the total income of the persons in thereof.
3. AO has the power to determine the income of such undertaking in accordance with the provisions of the Act.
4. Income so determined by AO is in excess of the income as shown in the accounts of the undertaking, such excess hall be deemed to be applied to purposes other than charitable or religious purposes.
5. **Sec 13(1)(d):** Any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year commencing on the 1st April, 1984 or any subsequent year.

Charitable Purpose

Surat Art Silk Cloth Manufacturers Association: 1980 AIR 387

1. The activity must be for profit to attract the exclusionary clause. Predominant object of the activity to be profit making
2. <u>An activity not pervaded by profit motive, carried on primarily for serving charitable purpose, is not an activity for profit.</u>
3. <u>An activity carried on with the predominant object of earning profit is an activity for profit, even if carried on in advancement of the charitable purpose</u>
4. Charitable purpose not to be submerged or masquerade profit motive.

Unrelated Profits and Gains– Sec 11(4A)

1. 11(1), 11(2), 11(3), 11(3A) not to apply in relation to income of a trust or an institution, being profits and gains of business.
2. Unless business is incidental to the attainment of the objectives of the trust or institution.
3. Separate books of accounts are maintained by such trust or institution in respect of such business.
4. Surplus resulting incidentally from the activity carried on by the educational institution would not debar the institution from claiming exemption – **Aditanar Educational Institution: (1997) 224 ITR 310 (SC)**

Prescribed Modes of Investment – Section 11(5)

1. Saving certificates issued by Central Government
2. Deposits in Post Office Savings Bank Account/Scheduled Bank Account
3. Units of UTI
4. Security for money created and issued by Central/State Government
5. Debentures whereof principal and interest amount is fully and unconditionally guaranteed by the Central/State Government
6. Investment or deposit in any PSU
7. Bonds issued by a financial corporation engaged in providing long term finance to industries, or any bonds issued by an Indian public company for providing long term finance to urban infrastructure
8. Immovable property
9. Deposits with IDBI
10. **Any other mode as may be prescribed – Rule 17C**

Investments in Shares of Companies

Sec 13(1)(d): Nothing contained in Sec 11 / 12 shall apply so as to exclude from the total income of the previous year of the person in receipt thereof.

1. If funds of the trust or institution are invested or deposited otherwise than in any one or more of forms or modes specified in Sec 11(5).

2. Any shares are held by the trust or institution after 30th Nov, 1983 – exception: (a) shares in a public sector company; (b) shares prescribed in Rule 17C.

3. **Other Exceptions:**
   - Any assets held by the trust or institution where such assets form part of the corpus of the trust or institution as on 1st June, 1973.
   - Any accretion to the shares forming part of the Corpus.
   - Any asset (other than Sec 11(5) assets) where such asset is not held by the trust or institution, otherwise than in Sec 11(5) forms or modes, after the expiry of 1 year from the end of the previous year in which such asset is acquired.

Registration of Charitable Trust

1. **Section 12A** – Creation of the trust or establishment of the institution

2. Distinction between "creation" and "establishment"

3. **"Created"** denotes with or without an instrument or a formal deed; **"Established"** demonstrates when there is an instrument in writing evidencing creation of trust.

4. **Madhya Pradesh High Court in Laxminarayan Maharaj & Anr.: (1984) 150 ITR 465** – Fact to be established is creation of the trust which can be established by producing constitutive and evidential documents. Trust created under an instrument requires production of constitutive document itself while establishment of trust can be proved by documents affording logical basis of inferring creation of trust.

Registration of Charitable Trust

5. Execution of formal trust deed not necessary for granting registration – **Tsurphu Labrang: TS 528 ITAT 2015 (Del.)**

6. Procedure for registration prescribed under **section 12AA**

   - Commissioner to call for such documents or information from the trust or institution to satisfy himself about the genuineness of activities of the trust or institution.

   - The Commissioner may make such enquiry as he deems necessary in this regard.

   - On being convinced qua the objects of the trust or institution and the genuineness of the activities of the trust, the Commissioner to pass an order in writing registering the trust or institution

Registration of Charitable Trust

Gujarat High Court in the case of Hiralal Bhagwati: 246 ITR 188

a. Registration u/s 12AA of the Act <u>not an idle or empty formality;</u>

b. Commissioner to <u>examine the objects of the trust; an</u> <u>empirical study of the past activities of the applicant</u>;

c. <u>Purpose</u> must be <u>directed to the benefit of the community</u> or a section of the community;

d. The expression "object of general public utility" not restricted to objects beneficial to the whole of mankind;

e. An object beneficial to a section of the public is an object of general public utility; the section of the community sought to be benefited to be sufficiently defined and identifiable by some common quality of a public or impersonal nature.

Registration of Charitable Trust

Karnataka High Court in the case of Sanjeevamma Hanumanthe Gowda Charitable Trust: 285 ITR 327

a. For the purposes of registration u/s. 12AA of the Act, authorities to satisfy the genuineness of the activities of the trust or institution,

b. To see the application of income derived from the trust property to charitable or religious purposes and

c. Nature of the activity by which the income was derived to the trust not relevant

Registration of Charitable Trust

Allahabad High Court in the case of Hardayal Charitable & Educational Trust: ITA No. 107/2012 dt. 15.03.2013

a. Where a trust, set up to achieve its objects of establishing educational institution, is in the process of establishing such institutions, and receives donations, registration u/s 12AA cannot be refused, on the ground that the Trust has not yet commenced the charitable or religious activity.

b. Any enquiry of the nature would amount to putting the cart before the horse.

c. At that stage only the genuineness of the objects has to be tested and not the activities, which have not commenced.

Registration of Charitable Trust

Delhi High Court in the case of Mool Chand Khairati Ram Trust: ITA 141/2013 dt. 27.07.2015

a. If a trust is registered u/s 12A of the Act, exemption u/s (s) 11 and 12 of the Act would not necessarily follow.

b. The provisions of section 12 of the Act do not curtail or in any manner dilute the mandatory requirements of section 11 of the Act.

c. Notwithstanding grant of registration u/s 12A, compliance with the conditions of section 11 of the Act necessary.

Provisions of section 11 not to apply in the following situations – Section 13

a. Any part of the income from the property held under a trust for private religious purposes which is not for the benefit of the public

b. Any income if the trust or institution is created or established for the benefit of any particular religious community or caste

c. Any income if a part thereof is applied directly or indirectly for the benefit of any person specified under section 13(3) of the Act

d. Any income if any of the funds are not invested in modes specified under section 11(5) of the Act

Forms for Accumulation of Income by Trust

1. **Notification 3/2016 dated 14-1-2016 -** Substitution of existing Rule 17 of the Income-tax Rules, 1962 w.e.f. 1-4-2016

2. **Form No. 9A** for **application** of income u/s 11(1)

3. **Form No. 10** for **accumulation/setting apart** income u/s 11(2) and as applicable u/s 10(21) for income of a research association

4. Forms to be furnished **electronically** under digital signature/electronic verification code

5. Notified forms come into force from **1-4-2016**

Trusts as Investment Vehicles

Business Trust – Section 115UA

*Section 2(13A): "**business trust**" means a trust registered as,—*

1. *an **Infrastructure Investment Trust** under the SEBI (Infrastructure Investment Trusts) Regulations, 2014 made under the SEBI Act, 1992 (15 of 1992); or*
2. *a **Real Estate Investment Trust** under the SEBI (Real Estate Investment Trusts) Regulations, 2014 made under the SEBI Act, 1992 (15 of 1992); and*
3. *the units of which are required to be listed on recognised stock exchange in accordance with the aforesaid regulations.*

Business Trust – Section 115UA

1. **Distribution of any income by a business trust to its unit holders:** Deemed to be of the same nature and in the same proportion in the hands of the unit holder as it had been received by, or accrued to, the business trust.

2. **Capital gains** chargeable to tax @ rates u/s (s) 111A and 112. **All Other income** chargeable to tax at MMR.

3. **Distribution of income u/s 10(23FC) or u/s 10(23FCA)**: Such income, on distribution deemed to be the income chargeable to tax of the unit-holder as income of the previous year – **Section 115UA(3).**

4. **Prescribed Statement** to be issued to the Unit holders giving the details of income etc**.**

5. **TDS on income distributed** to the unit holder - @ 10% from resident unit-holder and @ 5% from non-resident unit-holder – **Section 194LBA**

Alternate Investment Funds

1. **SEBI (AIF) Regulations, 2012** – Private pooled investment vehicle which collects funds from investors (Indian/foreign) for investment in accordance with defined investment policy
2. AIF can be set up as ***trust***, company, LLP or body corporate;
3. AIFs segregated into 3 categories, viz.
   a. **Category I** – AIFs that invest in **<u>start-up/ early stage ventures/sectors</u>** considered socially or economically more desirable and thus should be entitled to benefits and be subject to greater regulations.
   b. **Category II** – AIFs that **<u>do not apply any leverage or borrowing</u>** other than to meet day-to-day needs and as such do not get any special benefits.
   c. **Category III** – AIFs that **<u>employs diverse/complex trading strategies and may employ leverage</u>** (incl. investment in listed & unlisted derivatives)

Alternate Investment Funds

4. Only VCFs/ Category I AIF explicitly accorded ‘pass through status’.
5. **Section 115UB** –
   a. Business income earned by AIFs taxable at applicable rates.
   b. Capital gains and income from other sources taxable in the hands of investors in a similar manner as on investments made directly.
   c. No TDS on distribution by AIFs to Fund of Funds vide **CBDT Notification No. 51/2015 dated 24.06.2015**.
6. **CBDT Circular No. 13/2014 dated 28.07.2014**. Income of the trust taxable at MMR in the hands of the trustee (as representative assessee) where the trust deed:
   a) does not contain the name of the investors; or
   b) does not specify their beneficial interests.

Securitization Trust

1. **Chapter XII-EA** consisting of sections **115TA, 115TB and 115TC** inserted by the **Finance Act, 2013, w.e.f. 1-6-2013**

2. **Section 115TCA added by Finance Act 2016** levying tax on the investor's income from investing in Securitization Trust

3. **Securitization Trust – Defined under Explanation (d) to section 115TC** as special purpose distinct entity defined in Regulation 2(1)(u) of SEBI (Public Offer and Listing of Securitized Debt Instruments) Regulations, 2008

4. Overriding provisions in **section 115TA(1)** to levy tax on income distributed by securitization trust to its investors. Additional tax on distributed income **@ 25%** if distributed to **individual/HUF** and **@ 30%** for **any other person**. No deduction allowable against such income.

Securitization Trust

5. Tax to be remitted to the Government within 14 days from the date of distribution.

6. **Section 10(23DA) inserted by Finance Act, 2013, w.e.f. 1-4-2014 -** Income of Securitization Trust from securitization activity tax exempt

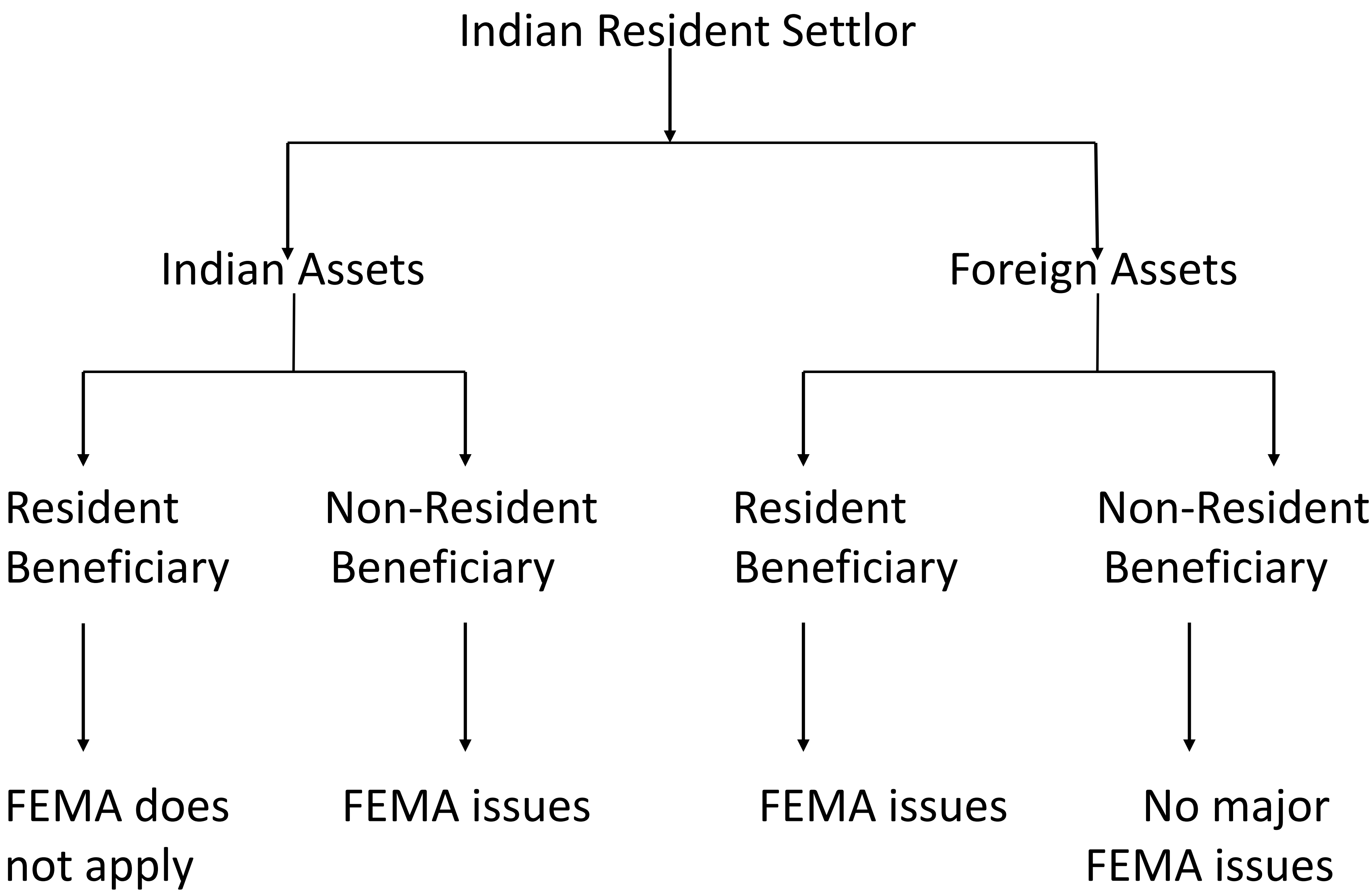
7. Special provisions qua taxability of securitization trust introduced post **Bombay High Court decision in the case of UTI Mutual Fund vs. ITO: WP No. 606/2012 –**

    a. Assessee, a MF, was a beneficiary of a securitization trust which received interest of Rs.21.49 crores and distributed the income to its beneficiaries in their respective shares. Assessment order on the trust passed in the capacity of an AOP; Demand enforced attaching assessee's bank accounts

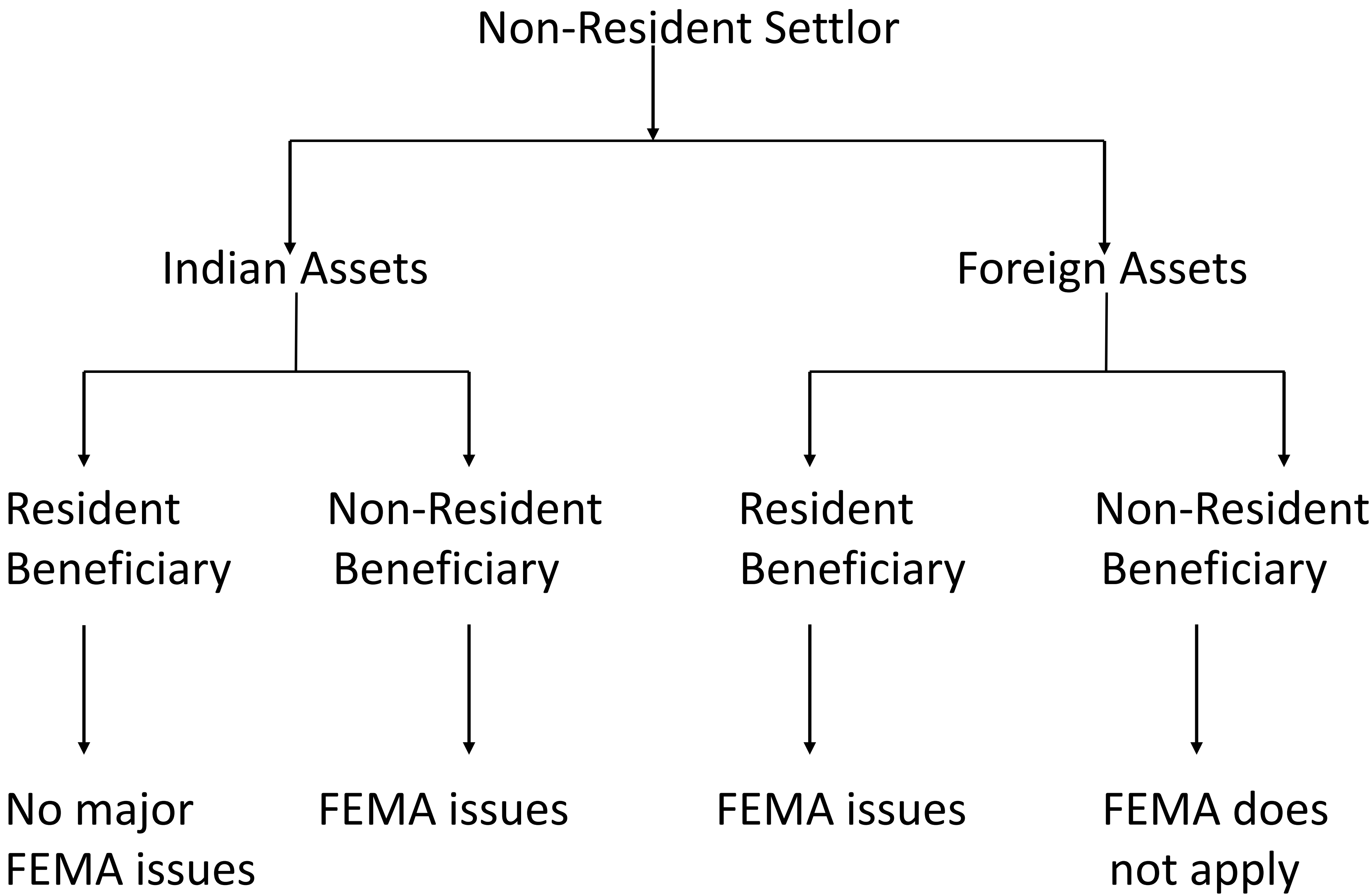
    b. High Court lifted the attachment and laid strictures for proper disposal of stay applications.

FEMA and TRUSTS

FEMA Aspects



FEMA Aspects



CBDT Circular 15/2015 dated 3-9-2015
[Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015]

Private trust created outside India by a settlor out of undisclosed foreign income chargeable to tax in India and set up a company holding 100% shares –

1. Declaration to be made by the settlor being the beneficial owner of the assets held under the trust.
2. Trustee may also make such declaration as a representative assessee. Non-resident trustee also eligible for declaration
3. Immunity available to the settlor, trustee and the beneficiary in respect of assets declared
4. Declaration to be made by beneficiary if settlor has passed away; or the guardian of the beneficiary if the beneficiary is a minor
5. The value of the asset declared not chargeable to tax on distribution of such assets to the beneficiaries

Thank you

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