A welfare state, with its logos and legend of social justice, has a sacred duty to promote the welfare of the people by achieving the new social order based upon a socialistic pattern of society. Article 38 of the Constitution of India enjoins the state to promote the welfare of the people, which in effect means that the state should look after the basic needs of its citizens, like medical care, education, relief of the poor and other similar objects.

In the recent past, the concept of laissez-faire state has changed. With the socio-political, scientific and technological development all over the world, the functions of the state are more and more confined to welfare activities rather than maintenance of law and order. The state, in turn, has assigned some of its welfare activities to charitable trusts. Thus, charitable trusts supplement the functions of a welfare state and the state, by giving tax incentives and concessions help the trusts to have funds for such activities.
On perusal of direct taxation system of various countries, one finds that state encourages religious and charitable trusts by offering tax immunity if they use their income entirely for the charitable purposes for which they have been set up and if they do not venture into any competitive trade. For example, the Tax Exemption Act, 1913 and the Internal Revenue Code, 1954 of the United States of America are the major encouragement to the establishment of many charitable trusts in the United States of America, which have completely supplemented the work of a welfare state. The most significant development has been the emergence of the Carnegie Foundation, the Rockefellers Foundation etc. Similarly, tax incentives and concessions were the encouraging force behind the establishment of Swiss based Ciba Foundation in England. And, in turn these charitable trusts did yeomen service to the society. The Ciba Foundation has eradicated malaria in England. The Rockfellers run many educational institutions in the United States of America, the University of Chicago is the concrete example. Ford Foundation, Russel Sage Foundation have fully shared the burden of a welfare state in field of education and medical care.

In India too, the charitable and religious institutions or funds are nothing new. There are a number of charitable and religious trusts in the country to serve the poor, the distressed, the needy, the destitute, the sick and the infirm. The history of religious and charitable activities started in India from ancient Hindu system called Vedic period. In Hindu system, there is no line of demarcation between religion and charity. The charitable acts are referred to as acts of construction of tanks, wells temples, planting groves, the gift of food, dharamshalas and places of supplying drinking water, the relief of sick, gifts for promotion of education and knowledge and so on. During the period of Buddhism, the most popular forms of charity were planting of trees for shade, wells, hospitals etc. Sankaracharya introduced Buddhist monastic institutions
into Hindu system named Mutts. With the dominance of Muslims, who were inspired by the same spirit of charity, a system of Zakat was introduced, which meant payment of one-fifth of one's income for charitable purposes.

The British Empire discovered that the income of many endowments both Hindu and Mohammedan were misappropriated. The British Government asserted its right of supervision over the endowed properties. Wilson's Income-tax Act, 1860 is the first tax statute to come in operation in India from 1st August, 1860. The Act exempted any property, movable or immovable, solely employed for or dedicated to religious or charitable purposes. The Income-tax Act of 1922 made many sweeping changes in the structure of tax provisions, assessment and exemption of tax on the income of religious and charitable institutions. Further, Income-tax Act, 1961 made major changes in the definition of 'Charitable Purpose' and sections 11, 12 and 13 were introduced providing exemption from income-tax, subject to certain conditions of application and accumulation of income of charitable trusts.

The motivation behind the modesty of the great charitable trusts and institutions have been good and even noble, but it has also been impractical. Indeed, it has been worse than impractical, for in the absence of convincing public evidence as to the value of trust activities, those who wish to discredit them have had the audience largely to themselves. There are, of course, some reasonable and important challenges which charitable trusts must face of which the principal challenge that confronts trusts is that why should these organisations be tax-free? The man in the street, acutely conscious of the range and magnitude of his own taxes, asks why is it fair that these great centres of concentration of wealth and power do not have to pay a rupee of tax?

Other questions that come to one's mind are whether these institutions are not sometimes (or even often) used to serve selfish and private ends?
"philanthropy" is supposed to be noble word, but are not some supposedly public philanthropic foundations, in fact, cleverly disguised personal ventures or private businesses?

Is it a good thing for our society to permit permanent concentrations of great wealth with all the power and temptation which accompany such concentrations? Are not some of the foundations dangerously big and is not the concentration even greater than it appears to be, because of confidential collusion of several or many big foundations, creating an "establishment" which decides who gets grant and who do not? Is this tax-free money not being used to advance some fairly questionable ideas?

Another question is why charities are established? Almost every thing that happens in the realm of human action is due not to one well defined cause but to a complex of interrelated causes. Some of the more important reasons for the establishment of charitable trusts are:

- Religious reasons,
- Egotistical reasons,
- The desire to thwart heirs,
- The desire to assure the continuance of a business,
- The desire to retain or at least prolong control of personal wealth,
- The desire to organise efficiently personal, family, or company giving,
- The desire on the part of a wealthy person to use money to bring his own ideas forcefully to the attention of others,
- The desire to aid a particular cause or to advance knowledge in a particular field,
The desire to serve mankind.

Charity is a human instinct that derives man to think favourably of others and do them good. It is being practised by mankind from ages immemorial and since then from simple individual acts of alms-giving it has now assumed institutional set up at times operating internationally to render maximum good to the largest number of people.¹

An example of institutional set up is "trust" which is a convenient method whereby a limited number of persons may hold property on behalf of other persons, who may be a large or fluctuating body or who may include persons not yet born. Once the property has been vested in the trustees, they own the property, but they are compelled by law to exercise their ownership for the benefit of the beneficiaries and for them only. It means legal ownership vests in the trustee or trustees but beneficiaries have defacto ownership.²

Trusts are either charitable or private in nature. Public trusts are also generally charitable trusts. A public or charitable trust is one which benefits the public at large, or some considerable portion of it.³ But in case of private trusts the beneficiaries are individuals or families and they are ascertained. In public or private trust, there is difference only in the process of its creation.

In creating a religious or charitable trust, a formal deed or any other writing is not necessary even if it involves immovable property. Therefore, a charitable or religious trust may be created by use of words, not necessarily in writing, but what is necessary is that there should be divesting of the property

on the part of the dedicator and it should vest in the trustee, a third person or dedicator as the case may be. Apart from the registration part, the basic tenets are the same in creating a valid trust whether religious or charitable or private trust that declaration of trust, deprivation of property and statement of object.

Coming to tax implications, depending on circumstances as prescribed in sections 161 and 162 of the Income-tax Act, 1961, a private trust can be taxed as an entity or as an association of persons. In case of trust, as association of persons, a higher rate of tax is prescribed. But if the shares of the beneficiaries are specific then trust will be taxed as a partnership firm.

In case of the religious and charitable trusts, the position is totally different. Keeping in view the fact that religious and charitable trusts are beneficial to the people at large and not to a class of specified persons, the scheme of the Income-tax Act exempts their income from the levy of the income-tax. But the exemption is granted only when the trust fulfils the conditions prescribed in sections 11, 12, 12A and 13 of the Act.

The provisions contained in the Income-tax Act relating to trusts are most complicated. These have become complicated because of several amendments which have been made from time to time for plugging the loopholes. But inspite of frequent 'undigested' amendments there are still loopholes which are being exploited by the tax-payers. On the other hand the honest assesses are being subjected to wanted restrictions. Hence, there is need to give a fresh look to the existing provisions so that the law relating to trust is stated in the simplest possible manner without any possibility of tax avoidance.

One of the area is definition of the term "charitable purpose" itself. The definition of "charitable purpose" underwent a vital change in order to
circumvent the decision of Privy Council in the celebrated case of Re, Trustees of the Tribune.\(^4\) In this case, a trust was publishing a newspaper, which charged its readers and advertisers at ordinary commercial rates and it made a profit. It claimed exemption in respect of the income it derived, on the ground that it was carrying on a charitable object; in that the supplying the province with an organ of educated public opinion was an "object of general public utility". The Privy Council held that the income of the trust running a printing press and a newspaper was exempt from tax as the object of "general public utility", viz., to supply the province with an organ of educated public opinion.

This decision opened the flood gates to tax avoidance as every business, being run by a trust for the benefit of general public could be considered to be for "general public utility". As it was not intended that exemption should cover business profits too (or else the other entrepreneur in the same line would be heavily loaded against competition) and prevent misuse of the section by commercial concerns, which while ostensibly serving a public purpose, get fully paid for the benefits provided. The definition "charitable purpose" was amended on the recommendation of the Select Committee to the effect that "the advancement of an object of general public utility" which involves the carrying on of any activity for profit should not come within the ambit of a "charitable purpose".\(^5\) The ten controversial words \textit{not involving the carrying on of any activity for profit} were added after the words "object of general public utility" in the Income-tax Act, 1961, so that the last or general category

\(^4\) (1939) 7 ITR 415 (PC).
\(^5\) Dasgupta, A.S. \textit{Charitable Trusts vis-a-vis taxation laws - changes over the years}. Indian Taxation, 1990 CTR Vol.2 at p.83
of "objects of general public utility" is qualified by the need to show that it did not involve any activity for profit.\(^6\) Thus, the definition of ‘Charitable Purpose’ in the Income-tax Act, 1961 became as follows:

"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."

This changed definition, no doubt, cut back on the amplitude of the expression in the earlier Income-tax Act, 1922 but still the implications of these words became the biggest bone of contention before the courts and opened flood gate to eternal litigation. Probably the highest number of legal battles have been fought on the dispute of the entitlement to exemption from tax by a trust or institution carrying on business on the ground of being for charitable purpose as envisaged in section 2(15) read with section 11 of the Income-tax Act, 1961. Even now (till the amendment of the definition of "charitable purpose", by the Finance Act, 1983), in spite of a plethora of the High Courts’ and the Supreme Court’s judgements on the dispute, the matter is yet to be crystallised beyond doubt; no objective test has been laid down as paramount or conclusive and the parameter of the legal concept of "charitable purpose" is still not clear. The matter has been further aggravated because of inclusive definition of "charitable purpose" involving a concept of charity. As observed by the learned judges of the Supreme Court, "Charitable Purpose" has never been at all defined or exhaustively illustrated. Unfortunately, the legislative simplicity has not been accomplished by the draftsmen in the amended definition, and consequently the interpretative complexity persists.\(^8\) The amendment instead of being clear and cogent is complicted and the courts have taken conflicting

\(^6\) Ibid.

\(^8\) Ibid.
views in interpreting the same. In view of this, these crucial ten words added
to the definition of charitable purpose, instead of solving the problem, created
more problems, especially in case of judicial interpretation. When the position
become more and more blurred, the Government on the recommendations
of the Chokshi Committee\(^7\) and on the basis of the Supreme Court decision
in Addl. CIT v. Surat Art Silk Cloth Manufacturers Association,\(^8\) deleted these
words from the definition 'Charitable Purpose' by the Finance Act, 1983 with
effect from 1st April 1984 and hence, profits and gains of business in the hands
of a charitable trust would not be exempt, except where the business fulfils
the conditions specified in section 11(4A)\(^9\) that business of a trust must be
incidental to the attainment of the objectives of the trust and separate books
of account are maintained by such trust in respect of such business.

While looking into the working and affairs of these trusts, the issues
which call for investigation are: the objective of the trust; performance of the
trust as to objects; use of trust property; scope for investing trust funds for
the benefit of the persons connected with the trust or for the benefit of the
business controlled by such trusts; responsibilities and liabilities of the trustees
as representative assessees, to pay taxes where the income and property of
such institutions are found to have been used for purposes, not germane to
the objects of the trust; authorised and unauthorised use of trust properties
by persons substantially interested in them, as to see, whether the funds belonging
to the trusts are invested or continue to remain invested, during the previous

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7 Officially the Committee was known as the *Direct Tax Laws Committee*, Dec. 1977, p.5.
8 (1980) 121 ITR 1 (SC);
9 Section 11(4A) was further amended by the Finance Act, 1991 with effect from 1st April 1992.
year in any concern in which the author or founder thereof or substantial contributor to it or their relative has a substantial interest etc.

Several trusts are not performing according to their objectives. The property of these trusts is used for the benefit of the interested persons of the trusts. To illustrate: The Sarabhais who have given generously to charity, contributed to the Arts, figured in the world of politics, stood for taste and distinction; and running many charitable trusts and institutions like Institute for destitute women and children; B.M. Institute for Handicapped children; National Institute of design etc. They also helped in establishing the Ahmedabad Textile Industry Research Association as well as Physical Laboratory and also played a role in starting the Indian Institute of Management in Ahmedabad. Despite these many and varied achievements, the Sarabhais are perhaps even more distinguished for their elegant taste and style, patenting a Gandhian austerity amidst refined wealth.

The Sarabhai Foundation, registered as a charitable trust, had a 16 acre farm which housed mango and lemon groves. The family claimed that these trees were for botanical research, and got tax exemption on this account. But surprise checks by the Income-tax authorities revealed that students hardly used the premises. The taxmen also found that the priceless Calico Mills of the Sarabhai Foundation had shifted from the Calico Mills to the Sarabhais' sylvan residential complex in Ahmedabad, The Retreat, where the museum was not really open to the public. Other facilities - like the books and music library, as well as botanical garden were also formed to be used primarily, if not exclusively, by the family.  

10 India Today, April 15, 1987, p.94.
There is a lot of scope for tax evasion through inter-trust donations, deductions provided to the trusts and property of trust in kind e.g. Jewellery, gold or other valuables etc. How this evasion of tax be checked? Whether the income of the trust after allowing deductions, be taxed?

A few years ago, Justice O. Chinnappa Reddy of Supreme Court, delivered a judgement in *McDowell's Case*, holding that "colourable devices" in tax planning tentamount to tax evasion. The judgement explicitly said that "though tax planning could be legitimate if within the framework of law, colourable devices could not be a part of tax planning and it was not honourable to avoid payment of tax by dubious methods as it was the obligation of every one to pay taxes honestly without resorting to subterfuges". It added that, "It was for the court to take stock, to determine the nature of the new and sophisticated legal devices to avoid tax, and expose the devices for what they really were and refuse to give judicial benediction".

Though this case will go a long way in preventing the creators of trusts by resorting to subterfuges and taking advantage in the name of tax-planning. It is to be seen how judiciary actively participates in fighting the tax evasion through trusts.

While proposing the guiding principles underlying the tax reforms, the Tax Reforms Committee popularly known as *Chelliah Committee* recommended.

"While the tax structure should be progressive, it should not be such as to induce the generation of unaccounted income and wealth."

Further the Committee recommended:

"The tax system must be rational from the economic point of view. For this purpose, the structure once established must remain stable unless and until the economic conditions undergo a radical transformation. Adhoc changes from year to year will undermine rationally and reintroduce complications."

The Judicial decisions of the courts are also not free from flaws and there is a need to reconsider the situations again. For example, where the object of the trust is charitable but profit is the real object of the trust, whether the trust will be treated as charitable trust because the dominant object of the trust is charity?

Some judicial decisions\textsuperscript{12} have held that if the primary object of a trust was of a charitable nature and the preference would be given to the needs of the relations and family members of the donor, the trust would be eligible for tax exemption. Now, the question arises, whether the tax exemption be given to such trusts where the trustees are asked to give preference to the poor relatives of the donor and the entire income is spent only on the relatives of the author?

The Supreme Court has held in \textit{CIT v. C.M. Kothari}\textsuperscript{13} that where the two transactions of transfer of property are interlinked and were part of the same transaction as device to avoid the tax liability, such transfers would fall in the scope of clubbing provisions and would be taxed in the hands of assesses. Whether the tax liability can be avoided if the transactions are skillfully devised.

\begin{thebibliography}{9}
\bibitem{footnote13} (1963) 49 ITR 107 (SC).
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Section 12 of the Income-tax Act, 1961 empowers the charitable trusts and institutions to receive voluntary contributions by way of donations towards the corpus of the trust without making the trust liable to income-tax and/or without making such trust or institutions spend the moneys in any specified manner or according to the directions of the assessing authorities.

Although the various High Courts have interpreted the above provisions but still the controversy persists as to whether the corpus donations should be treated as ordinary donations for the purposes of taxation? Can a trust receive debentures by way of donations? If so, whether such donations are against the spirit of section 13(1)(d) of the Income-tax Act? Further how misuse of donations in the form of cash, jewellery, cheques or hundies can be checked?

There is, at present no uniform central legislation to control and regulate the activities of charitable and religious trusts. There is a need of uniform code for such trusts so that working of such trusts can be watched properly and tax evasion through charitable trusts is curbed.

The proposed study has been divided in seven chapters. Chapter I titled "Introduction" examines the need and importance of Charitable trusts and their contribution to the society. It also discusses the reason for the establishment of Charitable trusts and judicial interpretation of the tax provisions regarding charitable trusts, the prevailing loopholes and flaws in the substantive provisions of tax laws and its judicial interpretation by the courts. It further discusses the social responsibilities of the business enterprises and contribution of some business group to charitable purposes.

Chapter II on historical background of Charitable trusts provides an overview on the charity in the ancient period. It analyses the origin and develop-
ment of charity and contribution of charity to the society. It also highlights the early tax provisions regarding charitable trusts and the meaning of charitable purpose. It also discusses the *The Tribune Trust Case Controversy*\(^{14}\) regarding the interpretation of word 'charitable purpose'. It also deals with the changes made in regard to exemptions provided to the charitable trusts from 1961 onwards. Section 11, 12 and 13 were amended by the Finance Acts are also discussed. Major change was brought into the definition of the word 'Charitable purpose' in 1983 by omitting *ten* controversial words and insertion of section 11 (4A) which further underwent change in 1991. A wholesale change made in the provisions relating to Public Charitable trusts by the Direct Tax Laws (Amendment) Act. 1987 by deleting sections 11, 12, 12A and 13 of the Income-tax Act, which were reintroduced in 1989 as they attracted lot of criticism and ultimately were dropped before they become operative, is discussed. Changes made by the Finance Act, 1991 and 1992 are also incorporated in this Chapter.

Chapter III is the focal point in the present study which deals with "Taxation of Religious and Charitable Trusts in India". This chapter deals with the concept of charity as interpreted by English and Indian courts and application of English law of charity in the Indian cases that charity must be of a public character, it must for the benefit of public at large not for the benefit of family members or relatives of the settlor of the trust. Attempt has been made to analyse the meaning of the word 'Charitable purpose' under section 2(15) of the Income-tax Act and controversy as arose regarding its interpretation. The bone of contention between legislature and the assessee with the business activity for profit, of the charitable trust which the legislature tried to restrict firstly in 1961 by adding the most controversial words *not involving the carrying on of any activity for profit* in the definition of charitable purpose which opened

\(^{14}\) (1939) 7 ITR 415 (PC).
the flood gates of eternal litigation. When the situation became more and more blurred until 1983 the legislature dropped the words from the definition and added section 11(4A) which further underwent change in 1991. The doctrine of 'dominant purpose' propounded by the Supreme Court, and formalities for the creation of a religious and charitable trusts are also discussed.

This chapter further deals with the exemptions provided to charitable trusts for the application and accumulation of income under section 11, exemption of voluntary contributions, registration of trust etc. The chapter also highlights the circumstances when an exemption provided to a charitable trust can be forfeited.

Further this chapter deals with the exemption provided to the religious and charitable trusts under Wealth-tax Act and Gift-tax Act.

Chapter IV contains provisions regarding private trusts established under Indian Trusts Act, 1882 and assessment of private trusts under tax laws. The provisions of the Indian Trusts Act, 1882 regarding meaning of trusts, formalities and three certainties, for the creation of a trust are discussed. It also deals with provisions regarding author of the trust, beneficiaries, trustees under Indian Trust Act, 1882.

The chapter further analyse the assessment of private trusts under tax laws. The chapter focuses its attention on those circumstances as to what will be the status of the trustee when more than one person are beneficiaries or when trustee carries on business of trust. An analysis on the judicial interpretation of these circumstances and principles laid down by the courts are discussed. The assessment of oral trust is also dealt with.

Chapter V on Global experience is an evaluative study on the tax incentives provided in the Commonwealth countries, European countries and the
United States of America. Attempt has been made to find tax patterns adopted by these countries and its application in Indian conditions.

The scheme of chapter VI is to provide a study on tax incentives for charitable contributions and tax avoidance through trusts. The role of charitable trust in socialistic pattern of society has been discussed. Tax incentives for charitable contributions or donations, donations for scientific research and rural development, donations for investment of business profits on socio-economic development schemes are main focus of this chapter. Exemption provided under section 10 to charitable organisations are also mentioned. The recommendation made by Tax Reforms Committee commonly known as Chelliah Committee in its interim report are also analysed. The contributions of various business groups towards rural development programme education and health care are also evaluated. The chapter also highlights about the National Committee for Promotion of Social and Economic Welfare which approves the schemes adopted by the voluntary organisations in the field of rural development and upliftment of weaker sections of the society. A study conducted by National Institute of Public Finance & Policy are also discussed in the chapter.

This chapter further deals with tax avoidance through trusts and a controversy arising after McDowell's case\textsuperscript{15} regarding tax avoidance. The application of McDowell doctrine in legitimate tax planning is also discussed. This chapter also highlights the latest position regarding legitimate tax planning after McDowell's case.

\textsuperscript{15} (1985) 154 ITR 148 (SC).
The concluding chapter VII attempts to draw certain conclusions from the study contained in earlier chapters and suggestions for a viable framework of law relating to charitable trusts and institutions.