CHAPTER II

HISTORICAL BACKGROUND

Religious and charitable trusts owe their origin to instincts of piety and benevolence which are ingrained in human nature. A trust would be called a religious or charitable trust, if it is created or dedicated for purposes of religion or charity. By a religious purpose is meant that the purpose or object is to secure the spiritual well being of a person or persons according to the tenets of the particular religion which one believes in. Charity means benevolence in its wide and popular sense and it comprehends all forms of benefit, physical, intellectual, moral or religious bestowed on persons who are in need of them. The form, content and method varied from society to society, depending upon its social needs values and cultural patterns.

In India too, the land of people - both high religious proclivities, 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.
CONCEPT OF CHARITY IN ANCIENT PERIOD

Charity is being practised by mankind from ages immemorial. Love for charity existed even in the feudal times.

According to Bhagwad Gita - "Charity is valid, if it takes into account Desh (place), Kal(time) and Patra (recipient). The forms of charity were Artha (money), Vidhya (education) and Abhaya (courage)."  

The history of religious and charitable acts started in India from ancient Hindu system called Vedic period. In the Hindu system there is no line of demarcation between religion and charity. Charity is regarded as a part of religion. Hindu religious and charitable acts have been classified from the earliest times under two heads: Istha and Purta. 

By "Istha" is meant vedic sacrifices, and rites and gifts in connection with the same. "Purta" or charitable acts are referred to as acts of construction of tanks, wells with flights of steps, temples, planting groves, the gift of the food, dharamashalas (rest houses) and places by supplying drinking water, the relief of the sick, gifts for promotion of education and knowledge, and so on. 

The next came the period of Buddhism. Under the influence of Buddhism, monastic institutions were established. The more popular forms of charity were, the planting of trees for shade, wells, hospitals etc.4

In the 8th Century A.C. Sankaracharya introduced these Buddhist monastic institutions into Hindu system named Mutts, which were to disseminate religious knowledge and to promote religious charity.5

In 13th and 14th centuries onwards the Muslims became dominant in India. They were also inspired by the same spirit of charity particularly in the field of religion and education. The system was called ‘Zakat’ which meant payment of one-fifth of one's income for charitable purposes. In Mohamedan Law, for the religious and charitable Acts, the word "wakf" is used.6

"Wakf" means a permanent dedication by a person professing the Mussalman faith, of any property for any purpose recognised by the Mussalman Law as religious, pious and charitable.7

The fall of the Mugal Empire saw complete disintegration of the administration machinery in the country. After the establishment of British Empire in India, it was discovered that the income of many endowments both Hindu and Mohomedan was misappropriated. The British Government asserted its right of supervision over the endowed properties. In 1810, a regulation was passed in respect of the province of Bengal under which general superintendence of these endowments vested in board of revenue. Similar

4 Ibid.
5 Ibid.
6 Supra.
regulations were passed for Madras and Bombay Presidencies in the year of 1817 and 1827 respectively.

Regulation of 1810 was amended and replaced by the Act XX, 1863. This Act was amended by Act XXI of 1925. In 1890, the Charitable Endowments Act was passed and this provided for vesting and administration of property held in trust for charitable purposes not of a religious nature.

The Indian trusts Act, 1882 was a progressive step in history of the trusts. This Act defines and amends the law relating to private trusts and trustees. The Act does not affect, the rules of Mohammadan Law as to Wakf or Hindu undivided family, or to trusts created before the 1st March, 1882.

CHARITY AND INCOME TAX LAW: (from 1860 upto 1961)

Wilson's Income-tax Act, 1860 (32 of 1860) is the first tax statute to come in operation in India from 1st of August, 1860. The nature, content and scope of the relevant provisions have not been uniform. So the Act lapsed in 1865. Income-tax was then called a duty. The Act exempted any property, movable or immovable, solely employed for or dedicated to religious or charitable public purposes, from duties. The power of exempting duties was vested in local Government, subject to the approval of Governor-General in Council. Which particular property was solely employed or dedicated to religious or public charitable purposes was to be determined by the Government not by the Income-tax Officer.

9 Ibid.
The Act of 1886 was promulgated and it provided the same conditions for exemption, but now the Local or Central Government has no longer discretion to grant or withhold exemption from tax.

By 1918, the British Government had realised its duty to respect public sentiments and feelings. So, the Income-tax Act, 1918 was passed, having a liberal recognition of the sentiments of the people in regard to religious or public charitable institutions and donations. This Act of 1918 was followed by the Indian Income-tax Act, 1922. The Act of 1922 made many sweeping changes in the structure of the tax provisions, assessment and exemption of tax on the income of religious and public charitable institutions.

The law relating to charities was significantly modified by the Indian Income-tax (Amendment) Act, 1939 (VII of 1939). This amendment was elaborately discussed in the case of Re the Trustees of the Tribune.\(^\text{10}\) Clause (ia) was inserted after clause (i) to section 4(3) and the exemption from tax was extended to any income derived from business carried on, on behalf of a religious or charitable institution, and the business is carried on in the course of the carrying out of a primary purpose of the institution and mainly carried on by the beneficiaries of the institution.

The amendment was effected to remove the hardship consequent upon the decision of the Madras High Court in \(\text{CIT v. Thevara Patasala,}\)\(^\text{11}\) following \(\text{The Governors of the Rotunda Hospital, Dublin v. Coman.}\)\(^\text{12}\) The definition of 'charitable purpose' was also affected by Act of 1939 as the private trusts' income was excluded from the ambit of exemption, which did not ensure for

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10 (1939) 7 ITR 415.
11 AIR 1926 Mad. 949.
12 (1921) 1 A.C. 1;
the benefit of the public. The *Income-tax Enquiry Committee* of 1936 also suggested certain limitations on the scope of business activities.

The new clause (ia) inserted by the Act of 1939 was independent from Clause (i) of Section 4(3). The former exempts income from business carried on, on behalf of a religious or a charitable institution, while the later exempts income from property held under trust for religious or charitable purposes. In *Charitable Gadodia Swadeshi Stores v. CIT*,\(^\text{13}\) Din Mohammad J., observed that Clause (ia) can be taken to apply to such business as is carried on, on behalf of religious or charitable institutions which were not held under trust. If it was intended to narrow down the scope of clause (i) so as to destroy the exemption enjoyed by a business held under trust or conducted by or on behalf of a religious or charitable trust, the new clause should have been added as a proviso to the old clause.

These observations were approved by the Supreme Court in *J.K. Trust v. CIT*.\(^\text{14}\) In this state of judicial pronouncements, the legislature brought in the amendments to the section by Act XIV of 1953 on the recommendations of the investigation commission and embodied the hint thrown by Din Mohammad J., in his observations.\(^\text{15}\) Therefore, proviso to section 4(3)(i) was added, in place of Clause (ia).

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13 (1944) 12 ITR 385.
14 (1957) 32 ITR 546 (SC).
15 *Supra* p.7.
The scope of the *proviso* was considered in *Dharma Vijay Agency v. CIT*¹⁶ by the Bombay High Court. The Kerala High Court in *CIT v. Krishna Warriar*¹⁷ and in *Dharmodayam Co. v. CIT*¹⁸ agreed with Bombay High Court's decision. Further Madras High Court¹⁹ and the Supreme Court²⁰ discussed the scope of *proviso* (b) to section 4(3)(i).

By the Finance Act, 1955 proviso (a) to section 4(3)(i) was recasted, in which the powers of the Central Board of Revenue were enlarged in the matter of granting exemption to the income of charitable trusts operating for the benefit of charity outside India, to promote international welfare in which India is interested. The new sub-clause gave the power to Board, to issue directions that income from public religious or charitable institutions would not be included in the total income under circumstances if such income was applied outside the taxable territory.

In this background, a thorough change was contemplated by the legislature in the Income-tax. The legislature considered the various reports of the committees for simplification and codification of the Act. The constitutional changes required serious consideration to avoid complications. The *Law Commission*, *Direct Taxes Administration Enquiry Committee* had submitted their reports to Government in regard to the structure of the Income-tax Act and the modifications which it required. On the basis of these reports, the *Income-tax Bill* of 1961 was introduced. The Bill was referred to the *Select Committee* in May, 1961 and after Committee's recommendations the Bill was passed by Par-

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¹⁶ (1960) 38 ITR 392.
¹⁷ (1962) 44 ITR 828.
¹⁸ (1962) 45 ITR 478.
¹⁹ *Thiagesar Dharma Vanikam v. CIT* (1963) 50 ITR 798.
liament and on receiving the assent of the President on 13th Sept. 1961, the Income-tax Act, 1961 (Act No. 43 of 1961) came into effect from the first day of April, 1962.

FROM 1961 ONWARDS

The Income-tax Act 1961, made the drastic changes in the definition of "charitable purpose" by inserting the restrictive words *not involving the carrying on of the activity for profit* in the end of the definition. These words introduced a new conception and distinguished Indian Law sharply from the English Law. These words also restrict the wider scope of "Charitable Purpose ".

Another major change was made in regard to exemptions. Before the Act, the whole income of the Religious and Charitable trust was exempted from tax, but by the Act, sections 11, 12 and 13 newly introduced, provide that only 25 per cent of the total income of trust would be accumulated and 75 per cent income should be applied on charitable acts. If accumulation is more than 25 per cent then it will be taxed.

It is in this respect, the Income-tax Act of 1961 makes a departure from all the earlier Acts. Under this Act, any income accumulated in excess of 25 per cent of the income from property held for charity is taxable under section 11(1) unless the special conditions regarding accumulation set out in section 11(2) are complied with and the different conditions have been prescribed to qualify for exemption in respect of business income (section 11(4) and section 13 (1).)

Further any charitable trust which is created on or after 1st April, 1962 would be disentitled to exemption if (i) the trust property is held in part only for charitable purposes (section 11(1)(b) or (ii)) the trust is for the benefit of any particular religious community or caste (section 13 (1) (b) or (iii)) any
part of income enures directly or indirectly for the benefit of the settlor or other specified persons (section 13 (i) (c) (2) and (3)). A religious trust which is created on or after 1st April 1962 would be likewise disentitled to exemption on the ground (i) or (iii), though not on ground (ii). Section 13 of this Act prescribes additional conditions for exemption which did not exist in the Act of 1922.

The gist of provision under section 13 is that the income may be exempted from being included in the total income of an assessee it must really be for the benefit of the public. The provisions are so wide in their application as to catch income from property held not only under trust but also from property held under other legal obligation.

The idea is to discourage frittering away of the income or its diversion for purposes which are not strictly public charitable purposes or religious purposes. If such income is really earmarked for the benefit of the community at large or the public then certainly the exemption can be claimed. The tendency to construct huge temples and spend money for installations of deities for private purposes is discouraged.

Soon after coming into force the Act of 1961, section 13 was amended by the Finance Act, 1963. The amendment was that if a trust for charitable purposes or institution is created or established for the benefit of any particular religious community or caste or the income enures directly or indirectly for the benefit of author or person having interest, such trust have exemption from tax.

Section 5 of the Finance Act, 1966 made the second amendment by substituting sub-clause (ii) of clause (b) of section 13. A trust, having charitable
purpose, created for the benefit of author, relative of such author, founder or a person having substantial interest, such trust can be exempted from tax.

Section 11 and 13 were amended to a substantial extent by sections 5 and 6 of the Finance Act, 1970 (19 of 1970) effective from 1st April 1971, with a view to check abuses and reducing the scope for the use of tax-exempt funds of charitable and religious trusts and institutions, to acquire control of business and industry. The effect of the amendment is that exemption from tax will be allowed only in respect of income actually applied for the purposes of the trust in India in the same year or within a period of three months immediately following. The provision for exemption from tax of accumulation of such income upto 25 percent of the income of the trust or Rs.10,000/- whichever is higher, has been dropped. Where any income is not applied to charitable or religious purposes in India but is accumulated for application to such purposes, such income shall not, be included in the total income of the previous year of person, provided he informs by notice in writing to the Income tax Officer, the purpose of accumulation, or the money so accumulated or set apart is invested in any Government security or deposited in any account with the Post Office Savings Bank, or a Co-operative Society or in an account with a financial corporation. If the income is not applied thus, it shall be deemed to be the income of such person of the previous year.

Another affected section was section 13. The amendment was that, nothing contained in section 11 shall operate so as to exclude from total income of the previous year of the person in receipt thereof - any part of the income from the property held under a trust from private religious purposes which does not enure for the benefit of the public, or, in the case of a charitable trust any income if the trust or institution is created or established for the benefit of any particular religious community or caste or, if any part of such
income or any property of the trust or institution is during the previous year used or applied directly or indirectly for the benefit of any person referred to in sub-section 3. The person referred in sub-section are (a) the author of the trust or the founder of the institution; (b) any person who has made a substantial contribution to the trust or institution; (c) where such author, founder or person is a Hindu undivided family, a member of the family; (d) any relative of any such author, founder, person or member as aforesaid; (e) any concern in which any of persons referred in (a) (b) (c) and (d) has a substantial interest.

In the newly added Explanation it is said that a trust created or established for the benefit of Scheduled Castes, Backward Classes, Scheduled Tribes or women and children shall not be deemed to be a trust or institution created or established for the benefit of a religious community or caste. Another Explanation explains 'Substantial interest' as in a case where the concern is a company if its shares carrying not less than 20 per cent of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of the other persons referred to in subsection 3.

The Finance Minister explained the amendment during Budget speech by observing:-

"These provisions will curb the use of the funds of charitable and religious trusts to acquire control over industry and business. Some changes are also being made to prevent indirect benefits being enjoyed by the authors or founders of such trusts. On the other hand, the present complete exemption from tax, which applies to Universities and other educational institutions, will also be applied in case of hospitals and other similar institutions."

28
The memorandum, issued by the Ministry of Finance, explaining the provisions of Bill also states:

"These concessions have facilitated accumulations of tax-exempt funds with charitable and religious trusts and such funds are often used for acquiring control over industry and business."

Circulars issued by Central Board of Direct Taxes.\textsuperscript{21} in this regard are also worth noting:

A circular of 19th June 1968 provides that the trust must spend at least 75 per cent of its income and not accumulated more than 25 per cent otherwise it will be taxable under section 11(1). Another Circular\textsuperscript{22} clarified that if a trust desires to accumulate income in excess of the limits laid down in section 11(1), the conditions specified in section 11(2) of the Act have to be fulfilled in respect of the entire accumulation and not merely in respect of the accumulation in excess of 25 per cent of the income.

Further, another circular\textsuperscript{23} was issued by the board on the subject "Capital gains arising to charitable or religious trust on sale of investments". This subject was earlier examined by the Board in 1963 and instructions were issued in its circular\textsuperscript{24}. So far as misuse of trust funds by making loans or deposits is concerned, the law has taken ample care of this clause (a) of sub-section (2) of section 13. This view was expressed by the Board in Circular No. 45.\textsuperscript{25}

\begin{itemize}
  \item 21 Circular No. 5P (LXX6) of 1968, Dated 19.6.1968.
  \item 22 Circular NO. 12P (LXX-3) of 1968 dated 26.11.1968.
  \item 23 Circular No.52, 30.12.1970.
  \item 24 Circular NO. 2-P (LXX-5) of 1963 dated 15.5.1963.
  \item 25 Circular NO. 45 (F.No. 131 (42)70-TPL) dated 2nd September, 1970.
\end{itemize}
Another important Board’s Circular\textsuperscript{26} explains the scope and ambit of section 13(2) (h) of Income-tax Act 1961 as substituted by the Finance Act, 1970.

\textit{Direct Taxes Enquiry Committee 1971}\textsuperscript{27} pointed out that these provisions overstep the limits of control and lead to undesirable consequences of stifling charity. The committee suggested to liberalise the provisions of section 11.

The amendments made by sections 5 and 6 of the Finance (No.2) Act, 1971 (32 of 1971) with effect from 1st April 1962, by adding sub-section (1A) after section 11, gave statutory footing to the matter which was so far regulated by the executive instructions. Capital gains arising on sale of property held under trust, wholly or in part, is deemed to have been applied for charitable or religious purposes of the trust if the net consideration received is used for acquiring another capital asset to be so held under trust, wholly or in part. The newly inserted \textit{Explanation} appended to sub-section (1A) provides the definition of appropriate fraction, cost of the transferred asset and net consideration.

In section 13(4), for the words "moneys of the trust or institution", the words "funds of the trust or institution" are substituted by this amendment.

The mandatory requirement that for being eligible for exemption from tax, the current income should be spent within the year itself, is rather harsh and unjust. This has also been recognised by \textit{Direct Taxes Enquiry Committee, 1971}\textsuperscript{28} The Committee recommended that the existing conditions for spending the trust income for charitable purposes within the same year or accumulating it in the specified manner should be relaxed, where the trust is prevented from

\textsuperscript{26} Circular NO. 51 (F.No. 152(49)70-TPL dated 23rd December, 1970.

\textsuperscript{27} \textit{Direct Taxes Enquiry Committee 1971, Report}, para 3.49, pp. 79-80.

\textsuperscript{28} \textit{Supra} para 3.65, p.82.
complying with them on account of not having actually received the income in question.


In this way, the provisions of newly introduced sub-section (1A) of section 11 placed the aforesaid administrative instructions on a legal footing and removed the disadvantage to charitable and religious trusts for the past as also the future.

Section 5 and 6 of the Finance Act, 1972 (16 of 1972) amended sections 11(1)(c), 12 and 13. The Finance Minister, during his budget speech 29 said that there are a number of other changes that are proposed in the Finance Bill for preventing evasion or avoidance of taxes and for rationalising the incentives available for promoting saving and investment. A few changes proposed, for example, in relation to taxation of charitable and religious trusts in the light of recommendations made by the *Wanchoo Committee* as given below.

The important change made was in the matter of voluntary contributions and conditions for registration of trust. Voluntary contributions received by such institutions will qualify for exemption from income-tax only, if these are applied to charitable or religious purposes or are accumulated for such purposes in the specified manner. The other important change made by introducing section 12A related to audit by a Chartered Accountant and compulsory registration for a trust to qualify for tax exemption, extension of the definition of

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relatives for judging whether the income or property of the trust is being used in a manner which would constitute disqualification from tax exemption and making the trust liable to pay wealth-tax when any part of the corpus or income of the trust is used for the benefit of the author of the trust, a substantial contributor to the trust or the trustees and their relatives, etc.

As a result of amendment, the definition of "income" has been extended to "Voluntary Contributions" for the purpose of Income-tax Act, Section 3(b) of the Finance Act, 1972 inserted sub-clause (iia) after section 2(24) giving the definition of "Voluntary Contributions".

In section 11 (i)(c), the words" income from property held under trust" are substituted by the words, "income derived from property held under trust".

Explanation I to section 13 was amended by this amendment, which provides that for this section and for the sections 11, 12 and 12A, "trust" includes any other legal obligations. Further, the explanation explains the term relative. Substitution of section 12 by section 6 of the Finance Act, 1972 is largely based on the following recommendations of the Direct Taxes Enquiry Committee, 1971\(^{30}\), which is as under :-

"We recommended that section 12 of the Income-tax Act, 1961 may be amended to provide that the benefit of tax exemption in respect of income received by way of voluntary contributions will be available only to charitable and religious trusts which enure wholly for the benefit of the public. Further, it may be provided that voluntary contributions received by religious and charitable trusts will be treated as income of such trusts for the purpose of Sections 11 and 13 of the Income-tax Act, 1961. However, voluntary contributions in the nature of endowments

\(^{30}\text{Supra, para 62, p.83.}\)
or for specific projects related to the objects of the trust may be allowed to be accumulated or set apart."

The Committee, also dealt with the subject of registration of trusts and audit of their accounts. Provisions of section 12A are largely the result of the recommendations of the Committee. Rule 17A (inserted by Income Tax (Second Amendment) Rules, 1973 w.e.f. 1.4.1973) prescribes that an application under Clause (a) of section 12A for registration of a charitable and religious trust or institution, shall be made in duplicate in Form 10A alongwith necessary documents. Rule 17B (inserted by Income-tax (Second Amendment) Rules, 1972 w.e.f. 1.4.1973) prescribes that the report of the audit of accounts of a trust or institution which is required to be furnished under clause (b) of section 12A shall be in Form No. 10B.

The important change proposed by Taxation Laws (Amendment) Bill, 1973 was to tighten the provisions relating to donations by imposing 65 per cent tax on donations to religious and charitable trusts where identity of the donor is not established. Clause 6 of the Bill provided that a person who contributes more than Rs.5,000/- in previous year would be considered as a "substantial contribution."

The Bill imposed a total ban on trusts claiming tax exemption, on investing any of their funds in any business concern including a limited company, not owned or controlled by the Government. But a period of five years is sought to be given to enable trusts to bring about the necessary changes in investments. The Bill did not become Act, and hence the proposed changes did not come into force.

31 Supra paras 3.52 and 3.53, pp. 80-81.
Taxation Laws (Amendment) Act, 1975 came as a sequel to the Taxation Laws (Amendment) Bill 1973. The Bill of 1973 was referred to the Select Committee which gave its report on 20th March, 1975. On the basis of the Report of the Select Committee, the Taxation Laws (Amendment) Act, 1975, was passed whereby far reaching changes in the provisions of the Income-tax Act, relating to charitable trusts and institutions have been made. Clause (a) and (b) of section 11 have been substituted. According to the amendment, income derived from property held under trust wholly for charitable or religious purposes to the extent to which such income is applied or accumulated for application to such purposes in India, to which the income so accumulated or set apart is not in excess of 25 per cent of the income from such property; income derived from property held under trust in part only for such purposes, where the trust having been created before the commencement of this Act, to the extent to which such income is applied or finally set apart for application to such purposes in India to which the income so set apart is not in excess of 25 per cent of the income from such property.

In computing the 25 per cent of the income which may be accumulated or set apart, any such voluntary contributions as are referred in section 12 shall be deemed to be part of the income. If in any previous year, the income applied to the charitable or religious purposes in India falls short of 75 per cent of the income derived during that year from property held under trust, or, as the case may be, held under trust in part, by amount (a) for the reason that the whole or any part of the income has not been received during that year or (b) for any other reason, so much of the income applied to such purposes in India during the previous year in which the income is received or during the previous year immediately following as does not exceed the said amount, may at the option of the person in receipt of income be deemed to be income applied to such purposes during the previous year in which the income was
derived and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes.

The amendment inserted sub-section (1A) to section 11 which provides that where any income in respect of which an option is exercised by the person in receipt of income, is not applied to charitable or religious purposes in India, then, such shall be deemed to be the income of the person in receipt thereof.

The Finance Act, 1975 amended sub-section 2 of section 11. According to the amended sub-section, where 75 per cent of the income is not applied, or is not deemed to have been applied to charitable and religious purposes in India during the previous year but is accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person in receipt of income in compliance of conditions specified.

The Finance Act, 1975 further inserted sub-section (3A). According sub-section (3A), where due to circumstances beyond the control of the person in receipt of income, any income invested or deposited cannot be applied for the purpose for which it was accumulated or set apart, the Income-tax Officer may, on an application made to him in this behalf, allow such person to apply such income for such other charitable or religious purpose in India as is specified in the application by such person and as is in conformity with the objects of the trust.

By the amendments made in the Finance Act, 1980 the loopholes for tax avoidance through the medium of discretionary trusts were plugged completely. Under section 164 of the Income-tax Act, the income received by the trustees of discretionary trust is chargeable to income tax at the flat rate of 65 per cent or the rate which would be applicable if such income were
the total income of an association of persons, whichever course is more beneficial to the revenue. With a view to obviating hardship in genuine cases where the circumstances were such that tax evasion could not be considered to be the main purpose of creating a trust, certain exceptions had been specified where the flat rate of tax of 65 per cent did not apply. These exceptions were as under:-

(i) Where none of the beneficiaries of the trust had any other income chargeable to income-tax.

(ii) Where the trust was created under a will.

(iii) Where a non-testamentary trust was created before 1st March, 1970 and the Income-tax Officer is satisfied that the trust was created bonafide exclusively for the benefit of the dependent relatives of the settlor.32

The effect of the amendments made by the Finance Act, 1981 was that an oral trust whose terms were not subsequently recorded in writing and intimated to the income-tax officer, would be subject to tax at the maximum marginal rate in all cases of an oral trust, the terms of which were subsequently recorded in writing and intimated to the Income-tax Officer in specified manner, would be chargeable to income-tax at the maximum rate in cases where the shares of the beneficiaries are indeterminate or unknown. Where, however, such shares are known, the tax would be levied and recovered from the trustee in same manner and to the same extent would be leviable or recoverable from the beneficiaries.

The ten words "not involving the carrying on of any activity for profit" in the definition of charitable purpose which were inserted in 1961, instead of solving the matter, created more problems, mainly as a result of judicial interpretation. Finally on the recommendations of Chokshi Committee\(^33\) these ten words were omitted from the definition by the amendment of Finance Act, 1983 with effect from 1st April 1984 and clause (4A) to section 11 was inserted which later on was substituted by the Finance (No.2) Act, 1991, with effect from 1st April 1992, namely:

"(4A) Sub-section (1) or sub-section (2) or sub-section (3) or sub-section (3A) shall not apply in relation to any income of a trust or an institution, being profits and gains or business, unless the business is incidental to the attainment of the objects of the trust or, as the case may be, institution, and separate books of account maintained by such trust or institution in respect of such business."

Further, the Finance Act, 1983 had substituted the scheme for investment pattern for income and wealth-tax purposes through the insertion of sub-section (5) in section 11 of the Income-tax Act effective from the assessment year 1983-84 to prescribe the items of investments or deposits as being statutorily in conformity with the investment pattern contemplated under the fiscal policy.

The Finance Act, 1984 amended section 11 by insertion of a new clause (xi) in sub-section (5) of section 11 to provide that one of the qualifying items of investments in approved financial assets prescribed for charitable trusts and institutions would be the deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964. Thus, investment of available funds of charitable trusts and institutions in respect

\(^33\) Officially the Committee was known as the Direct Tax Laws Committee, Interim Report on December 1977.
of corpus as well as the income in the deposits with Industrial Development Bank of India, whether short-term or long-term, would entitle the charitable and religious trusts and institutions to claim the benefit of exemption from income-tax under section 11 for the assessment year 1985-86 and subsequent years. Direct Tax Laws (Amendment) Act, 1989 inserted clause (xii) in sub-section (5) of section 11 effective from 1st April 1989 providing any other form or mode of investment or deposit as may be prescribed.

This amendment is one of the concerted efforts of the Government to provide funds for the business enterprises in the public sector at nominal rates of interest by divesting the available funds of charitable trusts and institutions through statutory compulsions.

The Finance Act, 1983 had made far reaching amendments to the provisions of section 13(1) with a view to prescribe as a mandatory provision that in any case where the funds of a charitable or religious trust or institution remain invested or deposited on or after 1st December, 1983, otherwise than in any of the forms or modes of deposit/investment prescribed under sub-section (5) of section 11 as stated, the trust would forfeit exemption from income-tax notwithstanding the fact that the income of the trust had been applied for charitable or religious purposes in accordance with the terms of the trust or objects of the fund as the case may be.

Very recently, the Finance (No.2) Act, 1991 inserted clause (iia) to the proviso to section 13(1)(d) of the Income-tax Act with retrospective effect from 1st April 1983, namely:

Provided that nothing in this clause shall apply in relation to any asset, not being an investment or deposit in any of the forms or modes specified in sub-section (5) of section 11, where such asset is not held by the trust or
institution, otherwise than in any of the forms or modes specified in sub-section (5) of section 11, after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st day of March, 1992, whichever is later;

It was also provided by the amendment to section 13 made by the Finance Act, 1983 effective from 1st April, 1983 that any funds representing the profits and gains of business relevant to the assessment year 1984-85 and subsequent years would not have to conform to the requirements of the investment pattern prescribed in sub-section (5) of Section 11 read with Section 13(1)(d). Accordingly, it was provided in sub-section (4A) of section 11 inserted through the Finance Act, 1983 which was substituted by the Finance (No.2) Act, 1991 effective from 1st April 1992 that the charitable trusts or institutions would not qualify for exemption of the profits and gains of any business unless the business is incidental to the attainment of the objectives of the trust.

A corresponding amendment was made in section 21A of the Wealth-tax Act from 1st April 1985 for imposing on each charitable or religious trusts and institutions the burden of wealth-tax at the maximum marginal rate unless the funds have been applied for charitable and religious purposes.

Section 164 of the Income-tax Act dealing with the rates of income-tax applicable to discretionary trusts was amended by the Finance Act, 1984 effective from the assessment year 1985-86 to insert a proviso to sub-section (2) of section 164 in addition to another proviso to sub-section (3) of section 164. The effect of the insertion of the proviso to sub-section (2) to section 164 is that in every case where the whole or any part of the relevant income which is not exempt under section 11 read with 12 and 13 (1)(c) or (d) of the Income-tax Act, the non-exempt income shall be charged to income-tax at the maximum marginal rate of tax prescribed by the relevant Finance Act and further the
proviso inserted to sub-section (3) of section 164 also seeks to provide that in a case where the whole or any part of the income of a charitable or religious trust or institution does not qualify for exemption under section 11 read with sections 12 and 13 of the Income-tax Act, the income which is not exempt must be subjected to income-tax at the maximum marginal rate of tax regardless of the fact whether such income is derived from a business or from any other source of investment or deposit which does not conform to the investment pattern prescribed in section 11(5).

Direct Tax Laws (Amendment) Act, 1987 made a wholesale change in the provisions relating to public charitable trusts by deleting sections 11, 12, 12A and 13 of the Income-tax Act, and introduced a new section 80F under the chapter VIA which deals with 'Deductions to be made in computing total income' with effect from 1st April 1989.

The salient features of section 80F were as follows:

1. Sub-section (1) of section 80F specified the categories of assesses to whom these provisions were applicable. Apart from persons in receipt of income derived from property held under trust for charitable or religious purposes in India, it also covered trusts or institutions which were (i) set up for the benefit of Indian citizens abroad; (ii) notified by the Board to be of national importance; and (iii) for promotion of international welfare in which India is interested.

Voluntary contributions received by such trusts, etc., would continue to be taxable in the same manner as provided in the un-amended section 12. Voluntary donations to the corpus of the trust would be taken as "income" defined in section 2(24).
An investment of the income of charitable trust should be made at least 6 months before the end of the accounting year or the due date for filing the return whichever later. A charitable trust which did not have an income from business, would have to file its return for income on or before June 30, 1989, for the accounting year ending on March 31, 1989. If the said charitable trust had to invest in specified investments prescribed by the Central Board of Direct Taxes for claiming deduction under section 80F, it has to invest in such investments before December 31, 1988. Provisions analogous to the unamended provisions of sections 11, 12A and 13 and Explanation 1 to 3 had also been incorporated in section 80F.

2. Sub-section (2) provided that the deductions under section (1) should be allowed unless the trust or institution had made an application for registration in the prescribed manner. Where the total gross income of the trust for the previous year exceeded fifty thousand rupees, its accounts must be audited and the return of income be accompanied by an audit report in the prescribed form. In addition to incorporating the conditions in the un-amended section 12A, power was taken by the Board for imposing such other conditions as it thought fit, keeping in view the interests or quantum of the revenue, including the condition to get nominated a person of the Board on the board of trustees or the governing body of the institution when application for registration made to the prescribed authority.

3. Sub-section (3) specified the circumstances in which no deduction was allowed under sub-section (1) to a trust or institution. Where the deduction was derived to a trust or institution under the circumstances where its income was deemed to have been used or applied, in a manner which results directly or indirectly in conferring any benefit, amenity or perquisite on any interested person in the trust, the Chief Commissioner was empowered on an application
by the trust or institution, to allow the deduction wholly or to such extent as he may deem fit, having regard to the extent of the benefit, amenity or perquisite derived of or enjoyed by the interested person.

These provisions were analogous to the unamended provisions of subsection (1) of section 13.

4. Sub-section (4) provided for the circumstances in which the income of a trust or institution should be deemed to have been used for providing any benefit, amenity or perquisite to any interested person. Provision of any such benefit or amenity would disentitle the trusts for the benefit of two deductions mentioned in sub-section (1). This incorporates the provisions contained in sub-section (2) of section 13.

5. Sub-section (5) provided that where any investment or deposit in which such amount was held by the trust, was realised or converted into cash, such amount should be deemed to be the income of the assessee of the previous year in which it was so realised or converted and should be chargeable to tax accordingly. This incorporates the principle of sub-sections (1-B) and (3) of section 11.

6. Sub-section (6) provided that if any income of a trust or institution was of such a nature as to attract the provisions of sections 60-63 of the Act, it would not be eligible for deduction under sub-section (1). This incorporates the condition given in the unamended sub-section (1) of section 11.

7. Section 80F (7) pertained to a trust carrying on or deriving income from a business which had to satisfy certain conditions that were required to be satisfied by such trusts for grant of deduction under section 11(1). These conditions include maintenance of accounts of the business on cash basis; prohibition of set-off and carry forward and set-off of business losses and ineligibility
of certain kinds of business and expenditure. This enlarged the area of the unamended provisions given in sub-section (4) and (4A) of section 11.

8. Sub-section 8 empowered the Board to delegate any power or authority, conferred upon it under this section, on an officer not below the rank of commissioner. The delegation was subject to such conditions and restrictions as the Board may think fit to impose.

The changes made by the Direct Tax Laws (Amendment) Act, 1987 though were made with the object of simplifying the scheme of exemption of charitable trusts and eliminating all restrictions on accumulations of their income yet they attracted lot of criticism and were dropped before they became operative. Palkhivala while commenting on Direct Tax Laws (Amendment) Act, 1987 observed that the income-tax law relating to charitable trusts would be made more complex than it had even hither-to been.

The Direct Tax Laws (Amendment) Act, 1989 reintroduced sections 11, 12, 12A and 13 with effect from 1st April 1989. Clause (d) to sub-section (1) of section 11 inserted in 1989 provides that income in the form of voluntary contributions made with a specific direction that these shall form part of the corpus of the trust or institution, shall be exempt from income-tax.

Following changes were made by the Finance (No.2) Act, 1991

1. Relaxation of time limit in the case of certain associations for investment of funds as specified (Effective from assessment year 1990-91):

In the case of associations and institutions in sections 10(21), (23) and (23c), a relaxation was as to the time limit within which any voluntary contribution received by them is required to be invested by way of investments/deposits under section 11(5). Accordingly, even if such voluntary contribution is invested
as per section 11(5) after the expiry of one year from the end of the previous year in which it is received, or by 31st March 1992 (whichever is later), the exemption with respect to it will apply.

"Voluntary contribution" for this purpose will not include cash or contribution received and maintained in the form of jewellery, furniture, or any other article as specified by the Board.

The association/institution entitled to the said relaxation will be as follows:

(a) Scientific research association (Section 10(21))  
(b) Sports/games association (Section 10(23))  
(c) Specified funds/institutions (Section 10(23C)).

2 New provisions as to exemption of income of trust or institution (Sections 11(4A), 13(1)(d) and (5))

In the case of a trust or institution, exemption will now apply even if it carries on business activities provided such activities are incidental to the attainment of the objectives of the trust or institution. However, the profits and gains from such business will be subject to tax. This will be effective from assessment year 1992-93.

Discretion of the Chief Commissioner or Commissioner to entertain a delayed application for registration of a trust/institution will now be limited to maximum three years from the date of creation of the trust or establishment of institution. This provision is effective from 1st October 1991.

If any asset of a trust is not held by way of investments/deposits (regarding investment of accumulated income) it is now required to be disinvested - (a) after the expiry of one year from the end of the previous year in which
it is acquired, or (b) 31st March, 1992 whichever is later. This provision is effective from 1st October 1991.

To remove certain anomalies and hardships arising out of the requirement of the investment pattern provided under section 13(1) (d), the Finance Act, 1992 has also made changes in section 13(1)(d) of the Income-tax Act.

Earlier, exemption from income-tax provided to a charitable or religious trust or institution was forfeited if after 28.2.1983 any funds of the trust or institution were not invested or deposited in any form or mode specified in section 11(5) of the Act. However, this forfeiture of exemption was not applicable to any assets held by trust or institution where such assets form part of the corpus of the trust or institution as on 1.6.1973 and such assets were not purchased by the trust or institution or acquired by it by conversion of, or in exchange for, any other asset or disposed of or converted into permissible investments within one year from the end of the financial year.

The Finance Act, 1992 provides that irrespective of the fact whether such assets are held originally by the trust or institution or they are acquired by conversion or exchange of original assets or purchased out of sale proceeds on transfer of the original asset, as the case may be, the provisions of section 13(1) (d) shall not be applicable in relation to such assets held by the trust or institutions.

With the insertion of a new (ia) in the proviso to section 13(1)(d) the provisions of section 13 (1) (d) shall not apply in relation to any accretion to the assets, being shares of a company forming part of the corpus of the trust or institution as on 1.6.1973, where such accretion arises by way of allotment of bonus shares.

These amendments are to take effect retrospectively from 1.4.1983.
The amendments made from time to time have brought drastic changes in the law of tax exemption for charitable trusts. The implications of these changes are obvious. Now, there is a little possibility that new charitable trust would spring up in future unless its authors are genuinely and exclusively motivated by the spirit of public welfare. The Government needs to think favourably about the genuine trusts and earn the gratitude of charitable trusts and institutions which are doing yeomen service to society.