Taxability of Voluntary Contributions and Computation Of Expenditure On Non-Taxable Income

The exempted Institutions falling within the meaning of 10(23C), such as :

- University or other Educational Institutions existing solely for educational purposes and not for purpose of profits,
- hospital or other Institution for the hospitality and treatment of persons suffering from illness or mental defectiveness or
- hospital or other Institution for the hospitality and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit are coming under taxation, based on their income from voluntary contributions. At present these institutions and trusts are availing tax benefits because of the specific exemption available under the Income-Tax Act. There are certain debatable issues and different interpretations are arising out of the donations or voluntary contributions received by these Institutions, religious trusts and charitable trusts.

In order to regulate all these institutions, the Finance Minister has proposed certain changes in the Finance Bill, 2006. The definition of the term "income" in clause 2(24)(iia) is extended to cover all the voluntary contributions or donations received by the University or other Educational Institutions or by Hospitals or other Institutions referred to in sub clause (vi) or sub clause (via) of section 10 [23C] as income retrospectively with effect from 1st day of April, 1999 i.e. for the assessment year 1999-2000 onwards. Hitherto the voluntary contributions received by a trust registered under section 12A only was covered under this definition.Further it is proposed to include in this definition of income, the voluntary contributions received by a University or other educational institution referred in sub clause (iii ad) or by any hospital or any Institution referred in sub clause (iii ae) of section 10(23C) of the Income tax Act with effect from 1st April 2007. In section 10(23C), there are different classifications among the public institutions based on the quantum of gross receipts and financial assistancetance from the Government. The institutions covered under sub-clause (iiiab) and (iiiac) are wholly run by substantial finance by Government and their income is fully exempted from the tax. The institutions specified in sub clause (iii ad) and (iii ae) such as university or any educational institution or hospital or other institution whose gross income or receipt does not exceed Rs. 1 crore in any financial year are not required to file returns of income with the department.

Whereas, in the case of institutions specified in clause (vi) and (via) whose gross income or gross receipts exceed Rs.

1 crore must be approved by the prescribed authority for claiming exemption from taxation. These institutions are required to file the return of income within the time limit specified under section 139(1).

There was a proposal in the year 1973 on the recommendation of Wanchoo Committee to tax the unidentified donations received by the charitable or religious trusts. But subsequently, based on the recommendations of the Select Committee of the Parliament, it was withdrawn. The growth in the number of institutions under this exempted category was closely monitored by the Government and it was found that the donations received by these institutions from unidentified persons were out of tax net. In the case of *Director of Income-tax (Exemption) Vs. Keshav Social & Charitable Foundation (2005) 146 Taxman 569 (Del.)*, the High Court has held that even when the donations were received by the trust from donors who were fictitious persons and the trust was unable to explain it properly, such donations were not taxable.

In the present case, the assessee had not only disclosed its donations, but had also submitted a list of donors. The fact is that even if complete list of donors was not filed and that the donors were not produced, it does not necessarily lead to the inference that the assessee was trying to introduce unaccounted money by way of donation receipts. The Court further held that the Assessing Officer cannot apply section 68 because the assessee had in fact disclosed the donations as its income and it cannot be disputed at all that receipts other than corpus donations would be income in the hands of the assessee.

Applying this principle, the donations or voluntary contributions from any unidentified persons or any anonymous donations cannot be taxed under any provisions of the Income tax Act. A similar logic can be applied for the institutions specified under section 10(23C).

The Finance Bill, 2006 proposes that all the voluntary contributions received by a university or other educational institution or Hospital or any other institution irrespective of the fact whether their gross receipts exceed Rs.1 crore or not should be treated as income.

In view of this, two new sections are proposed to be inserted viz section 13(7) and section 115BBC. As per new section 13(7), the operation of sections 11 and 12 in relation to the exempted trust relating to anonymous donations referred in section 115BBC is to be excluded and such anonymous donations will be treated as part of the total income. The proposal is focusing on these institutions specified in section 10 [23C] and trusts or institutions referred to in section 11 and includes any income by way of anonymous donations. As per the new section 115BBC any income by way of anonymous donations of the entities referred to in section 10(23C) shall be subject to income-tax. These entities are required to pay the tax aggregate of tax calculated on the income by way of any anonymous donations at the rate of 30% and the amount of tax with which the Assessee would have been chargeable as per the regular provisions.

The explanation for anonymous donations as per sub section 3 of section 115BBC provides that anonymous donations means any voluntary contribution referred to in sub clause (ii a) of clause 24 of section 2, where a person receiving such contribution does not maintain the record

of identity by indicating the names and addresses of the persons making the donation and such other particulars as may be prescribed.

There is a specific exemption available for the trusts or institutions created or established wholly for the religious purposes. Only those Institutions created or established wholly for the religious purposes are exempted from the taxability of anonymous donations. Similarly, anonymous donations received by any trust or institution created or established wholly for both religious as well as charitable purposes come within the scope of section 115BBC, only if such anonymous donations are made with a specific direction that such donation is for any university or other education institutions or any hospital or other medical institution run by such trust or institution.

Whether any sum is found credited in the books of an assessee maintained for any previous year, if the assessee had not offered proper explanation about the nature or source thereof or the explanation offered is not to the satisfaction of the Assessing Officer, that amount should be treated as income of the assessee of that previous year. At present, there are a number of cases where these institutions offered this unexplained credit as income and have claimed that they have applied the income to the extent specified under section 11, i.e. 85% for charitable or other objects for which they have been established. Hence, they claim that they are not subject to taxation.

Now the definition of anonymous donation will widen the powers of the Assessing Officer to enquire specifically with reference to section 68 and other donations received by these institutions. These institutions would be required to maintain proper details to prove beyond the doubt, the names and addresses and means of the persons who donate the money. Otherwise, the Department will take a different view with reference to section 115BBC and subject the donations for taxation. Even though, where all the details are given under section 115BBC regarding the Donors, the Assessing Officer still has the power to enquire into them.

The voluntary contributions received by these institutions or charitable trusts are to be utilized only for the purpose for which they have been established. There is no specific definition relating to what is a voluntary contribution under the Income-tax Act, 1961. Broadly, there are two types of voluntary contributions – one is voluntary contribution in the form of donation for general purpose and the other is donation for specific purpose or corpus donation. In the Income Tax Act, 1961, there is no definition for "corpus donation", however, the distinction between the two can be established with reference to section 11(1)(d) and section 12 both read together with section 2 (24) (iia) that the voluntary contributions received with a specific direction that they should form part of the corpus of the trust are not includible in the total income. However, the applicability of section 115BBC cannot be ignored. The definition of anonymous donation will cover both regular donation and corpus donation. The donation received in kind but if it is not properly explained, can also be treated as anonymous donations. This proposed amendment will set right certain anomalies and disputes with reference to income of the exempted trusts and institutions.

As per the Memorandum explaining the provision in the Finance Bill, 2006, the proposed section 115BBC will cover the following institutions:

(i) Any trust or institution referred to in section 11;

(ii) Any university or other educational institution referred to in section 10(23C) (iiiad) and (vi);

(iii) Any hospital or other institution referred to in section 10(23C) (iiiae) and (via);

(iv) Any fund or institution referred to in section 10(23C) (iv);

(v) Any trust or institution referred to in section 10(23C) (v)

Whether the Assessing Officer empowered under section 142A for the purpose of assessment can refer the case to the valuation cell to find out the cost of construction of the property belonging to the trust or institutions and thereafter add the difference between the cost disclosed in the books of account and the value determined by the valuation cell treating the same as anonymous donation?

Will acceptance of anonymous donations lead to the withdrawal of exemption granted by the prescribed authority or cancellation of a registration granted under section 12A is another debatable issue.

Computation of Expenditure on Non-Taxable Income

The existing section 14A of the Income-tax Act was introduced through the Finance Act, 2001 retrospectively with effect from 1.4.1962 to nullify the decision of the Apex Court in Rajasthan State Warehousing Corpn. Vs. CIT (2000) 242 ITR 450 (SC). The Apex Court in its decision held that where an assessee is carrying on an indivisible business yielding taxable and non-tax-able income the entire expenditure can be deducted without any apportionment of expenditure relating to non-taxable income. In view of the retrospective amendment by inserting section 14A, the Finance Act, 2001 set rest all the controversies relating to the claiming of expenditure, commonly with taxable and non-taxable income.

The solid and deliberate intention of retrospective legislation was, warranted to tax the correct income. The total income as per section 2(45) computed in the manner laid down in this Act referred to in sec- tion 5 has to be computed with reference to the permissible deductions specified in section 15 to 59 for all the sources under the five heads as mentioned in section 14. There are a number of disputes among the taxpayers relating to allocation of expenditure against the non-tax-able income and the method adopted in each case. There is considerable debate on this issue. The assessees having non-taxable income such as dividend, tax free interests etc. are apportioning expenditure, proportionately. However, there was always difference of opinion in computation. The Bill proposes to insert two new clauses under section 14A so as to provide a method of apportionment of expenditure against taxable and non-tax-able income.

As per the proposed new subsection 2 in section 14A, it is mandatory for the Assessing Officer to determine the amount of expenditure incurred in relation to such income which does not form part of the total income. The Government will prescribe the method of computation and it has to be applied only when the Assessing Officer is not satisfied with reference to the accounts maintained by the assessee and as to the correctness of the claim of expenditure

relating to the income not includible in the total income of the assessee. Further, the new sub section 3 to section section 3 to section 14A empowers the Assessing Officer to apply the method of computation where the assessee has claimed that he has not incurred any expenditure in relation to income which does not form part of the total income. This amendment will be applicable with effect from 1st April 2007 and accordingly apply in relation to assessment year 2007-08 and subsequent years.

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