

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

AMENDMENTS BY THE FINANCE (No.2) ACT, 2014

CHARITABLE TRUSTS AND INSTITUTIONS

S. No.	Particulars		
(a)	Registered trusts and institutions which are eligible for exemption under sections 11 to 13 not allowed to claim exemption under any of the clauses of section 10, other than exemption available under clauses (1) and (23C) of section 10 Sections : 11(7) & 10(23C) Effective from : A.Y.2015-16		
	Issue	Need for amendment	Amendment
	In the case of charitable trusts and institutions, the rationale of providing exemption is to ensure that income derived from the property held under trust is applied and utilised for the object or purpose for which the institution or trust has been established. However, many registered trusts or institutions claiming benefits of the exemption regime do not apply their income, which is derived from property held under trust, for charitable purposes. Consequently, when the income becomes taxable, the trusts and institutions resort to claiming exemption under general	Once an institution or trust voluntarily opts for the special dispensation under sections 11, 12 and 13, it should be governed by these specific provisions and should not be allowed flexibility of being governed by other general provisions. Allowing such flexibility has adverse effects on the objective for which these sections were enacted.	Section 11 has been amended to provide that where a trust or an institution has been granted registration for purposes of availing exemption thereunder, and the registration is in force for a previous year, then such trust or institution cannot claim any exemption under any provision of section 10 [other than exemption of agricultural income under section 10(1) and exemption available under section 10(23C)].

	provisions of section 10 and thus, avoid tax on such income. As a result, the very purpose of requirement of application of income etc. in respect of income derived from property under trust is defeated. This issue also arises in the context of section 10(23C) which provides for exemption to funds, institution, hospitals, etc. which have been granted approval by the prescribed authority. Section 10(23C) also has similar conditions of accumulation and application of income, investment of funds in prescribed modes etc.	Likewise, entities which have been approved or notified for claiming benefit of exemption under section 10(23C) would not be entitled to claim any benefit of exemption under other provisions of section 10 [except exemption under section 10(1) in respect of agricultural income].	
(b)	Disallowance of depreciation on commercial lines in respect of a capital asset, cost of acquisition of which has been claimed as application of income Sections: 11 & 10(23C) Effective from: A.Y.2015-16		
	Issue Both section 11 as well as section 10(23C) provide exemption in respect of income applied to acquire a capital asset for promoting the objects of the trust. Subsequently, while computing the income for purposes of these sections, notional deduction by way of depreciation etc. is claimed due to which only the net amount after deduction of depreciation is required to be applied for charitable purposes. In effect, the amount of depreciation is not required to be applied for charitable purposes. Resultantly, trusts and institutions resort to claiming dual benefit of the same expenditure (namely, expenditure on acquisition of capital asset) under the existing law.	Need for amendment The allowance of dual benefit is not in accord with the true intent of law.	Amendment Sections 11 and 10(23C) have been amended to provide that income for the purposes of application shall be determined without allowing any deduction for depreciation or otherwise in respect of any asset, the cost of acquisition of which has been claimed as an application of income under these sections in the same or any other previous year.

(c)	Meaning of "Substantially financed by the Government" for the purpose of exemption under sub-clauses (iiib) and (iiic) of section 10(23C) Section: 10(23C) Effective from: A.Y.2015-16		
	Issue	Need for amendment	Amendment
	Income of certain educational institutions, universities and hospitals which exist solely for educational purposes or solely for philanthropic purposes, and not for purposes of profit and which are wholly or substantially financed by the Government are exempt under section 10(23C).	There is no definition of the phrase "substantially financed by the Government" under the Income-tax Act, 1961, which has led to litigation resulting in varying decisions of judicial authorities, based upon the other provisions of the Income-tax Act, 1961 and other Acts on which they have placed reliance.	An Explanation has, therefore, been inserted after section 10(23C)(iiic) to clarify that if the government grant to a university or other educational institution, hospital or other institution during the relevant previous year exceeds a percentage (to be prescribed) of the total receipts (including any voluntary contributions), of such university or other educational institution, hospital or other institution, as the case may be, then, such university or other educational institution, hospital or other institution shall be considered as being substantially financed by the Government for that previous year.
(d)	Power of Principal Commissioner/Commissioner to cancel registration of trust or institution expanded Section: 12AA Effective from: 1.10.2014		
	Issue	Need for amendment	Amendment
	Under section 12AA, the registration once granted to a trust or institution shall remain in force until it is cancelled by the Commissioner. Section 12AA(3) provides the	On account of the restrictive interpretation of the powers of the Commissioner under section 12AA, registration	In order to rationalise the provisions relating to cancellation of registration of a trust, sub-section (4) has been inserted in section 12AA. It provides that where a trust or an institution has been granted registration, and

	following two circumstances in which the Commissioner can cancel the registration of the trust : (a) the activities of the trust or institution are not genuine; or (b) the activities are not being carried out in accordance with the objects of the trust or institution. The Commissioner is empowered to cancel the registration only if either or both the above conditions are met, and not otherwise. The powers of Commissioner to cancel registration are, therefore, highly curtailed.	of such trusts or institutions continues to be in force and these institutions continue to enjoy the beneficial regime of exemption, even if they have not properly applied their income for charitable purposes or diverted such income for benefit of certain interested persons or invested their funds in prohibited modes.	subsequently it is noticed that its activities are being carried out in such a manner that,— (i) its income does not enure for the benefit of general public; (ii) it is for benefit of any particular religious community or caste; (iii) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or (iv) its funds are invested in prohibited modes, then, the Principal Commissioner or the Commissioner may cancel the registration of such trust or institution. However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.
(e)	Taxability of anonymous donations exempt from applicability of maximum marginal rate of tax Section : 115BBC Effective from: A.Y.2015-16	Need for amendment	Amendment
	Section 115BBC provides for levy of tax at 30% in case of certain assessee, being university, hospital, etc. on the amount of aggregate anonymous donations exceeding 5% of the total donations received by the assessee or ₹ 1 lakh, whichever is higher.	The correct method of computation is to reduce the income by the amount of anonymous donations which has actually been taxed at the rate of 30%.	Section 115BBC has been amended to provide that the income-tax payable shall be the aggregate of— (i) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or

On account of the mechanism of aggregation of tax provided in section 115BBC, while income-tax@30% is levied on the amount of anonymous donations exceeding the threshold, the remaining tax is chargeable on total income after reducing the entire amount of anonymous donations.	(ii) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by the assessee or ₹ 1 lakh, as the case may be.	one lakh rupees, whichever is higher; and
Example <i>Income from property held under trust is ₹ 6 lakh. The voluntary contributions received by a trust is ₹ 20 lakh, which includes anonymous donations of ₹ 4 lakh and corpus donations of ₹ 5 lakh. The trust has applied ₹ 10 lakh to purchase a building on 1.8.2014 for meeting its objective. Compute the tax liability of the trust for A.Y.2015-16.</i>		
Answer		
Particulars	₹	₹
Income from property held under trust ¹		6,00,000
Voluntary contributions	20,00,000	
Less: Corpus donations (not taxable)	5,00,000	
	15,00,000	
Less: Anonymous donations (taxable@30% under section 115BBC) [₹ 4,00,000 – ₹ 1,00,000]	3,00,000	
		12,00,000
		18,00,000
Less: 15% of income eligible for retention/accumulation without conditions ²		2,70,000
		15,30,000

¹ Depreciation on building is not allowable since cost of acquisition of building has been claimed as application of income. It is assumed that depreciation on building has not been charged while computing income from property held under trust.

² A view is taken that 15% of ₹ 1 lakh, representing the amount of anonymous donations exempt from applicability of 30% tax, is also eligible for retention/accumulation without conditions in line with other voluntary contributions. A contrary view may also be possible due to the language used in section 13(7), that such anonymous donations chargeable to tax at normal rates are not eligible for retention/accumulation. If this view is taken, ₹ 2,55,000, being 15% of ₹ 17,00,000 has to be set apart (instead of ₹ 2,70,000, being 15% of ₹ 18,00,000).

	Less: Purchase of building for the purpose of the trust Total Income (excluding anonymous donations taxable@30%) 10,00,000 5,30,000									
The tax payable by the trust would be the aggregate of – (i) ₹ 90,000, being income-tax calculated@30% on ₹ 3 lakh (i.e., ₹ 4 lakh – ₹ 1 lakh); and (ii) ₹ 31,000, being income-tax calculated at normal rates on ₹ 5.30 lakh (i.e., ₹ 5,30,000). The total tax payable would be ₹ 1,24,630 (₹ 1,21,000 plus cess@3%)										
(f)	Registration granted to trust or institution to also be applicable to earlier years in specific cases Section: 12A Effective Date: 1.10.2014 <table><tr><th>Issue</th><th>Need for amendment</th><th>Amendment</th></tr><tr><td>Under section 12A, a trust or an institution can claim exemption under sections 11 and 12 only after registration under section 12AA has been granted. Also, in case of trusts or institutions which apply for registration after 1st June, 2007, the registration shall be effective only prospectively.</td><td>On account of non-registration, tax liability gets attracted in those years even though they may otherwise be eligible for exemption due to compliance with other substantive conditions. The present provisions of the Act also do not permit condonation of delay in seeking registration.</td><td>In order to remove the genuine hardship and provide relief to the trusts, section 12A has been amended. <u>Circumstance when exemption would be granted for an earlier assessment year:</u> In case where a trust or institution has been granted registration under section 12AA, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust in any assessment proceeding for an earlier assessment year which is pending before the Assessing Officer as on the date of such registration.</td></tr><tr><td>Non-application of registration for the period prior to the year of registration causes genuine hardship to charitable organisations.</td><td></td><td><u>Condition for grant of such exemption:</u> The objects and activities of such trust or institution in the relevant earlier assessment year should be the same as those on the basis of which such registration has been granted.</td></tr></table>	Issue	Need for amendment	Amendment	Under section 12A, a trust or an institution can claim exemption under sections 11 and 12 only after registration under section 12AA has been granted. Also, in case of trusts or institutions which apply for registration after 1st June, 2007, the registration shall be effective only prospectively.	On account of non-registration, tax liability gets attracted in those years even though they may otherwise be eligible for exemption due to compliance with other substantive conditions. The present provisions of the Act also do not permit condonation of delay in seeking registration.	In order to remove the genuine hardship and provide relief to the trusts, section 12A has been amended. <u>Circumstance when exemption would be granted for an earlier assessment year:</u> In case where a trust or institution has been granted registration under section 12AA, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust in any assessment proceeding for an earlier assessment year which is pending before the Assessing Officer as on the date of such registration.	Non-application of registration for the period prior to the year of registration causes genuine hardship to charitable organisations.		<u>Condition for grant of such exemption:</u> The objects and activities of such trust or institution in the relevant earlier assessment year should be the same as those on the basis of which such registration has been granted.
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	<u>Reassessment proceedings not to be initiated for earlier years due to reason of non-registration:</u> No action for reopening of an assessment under section 147 shall be taken by the Assessing Officer in the case of such trust or institution for any assessment year preceding the first assessment year for which the registration applies, merely for the reason that such trust or institution has not obtained the registration under section 12AA for the said assessment year. <u>Non-availability of above benefits to a trust or institution in certain cases:</u> The above benefits would, however, not be available in case of any trust or institution which at any time had applied for registration and the same was denied or a registration granted to it was cancelled at any time under section 12AA.
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2. **Taxability of Awards received by a Sportsman [Circular No. 2/2014 dated 20.01.2014]**

The CBDT had issued Circular No.447 on 22nd January, 1986 clarifying that awards received by a sportsman, who is not a professional, will not be liable to tax in his hands as the award will be in the nature of a gift and/or personal testimonial. This Circular was applicable when the gift was not taxable in the hands of the recipient. Thereafter, in the year 2005, there was a fundamental change in the manner of treatment of gift through insertion of sub-clauses (xiii), (xiv) and (xv) of section 2(24). Corresponding amendments were also made in section 56(2) by insertion of clauses (v), (vi) and (vii), thereby making an amount of money or immovable property received without consideration taxable subject to provisions of these clauses. Consequently, the CBDT has, through this Circular, clarified that *Circular No.447* had become inapplicable w.e.f. 1-4-2005, since the statutory provisions have overridden the same.

It may however be noted that, in terms of provisions of section 10(17A), Central Government approves awards instituted by Central Government, State Government or other bodies as also the purposes for rewards instituted by Central Government or State Government from time to time. Tax exemption can be sought by eligible persons in respect of awards or rewards covered by such approvals.

3. **Clarification regarding disallowance of expenses under section 14A in cases where corresponding exempt income has not been earned during the financial year [Circular No. 5/2014, dated 11.2.2014]**

The Finance Act, 2001 had introduced section 14A, with retrospective effect from 1st April, 1962, to provide that no deduction shall be allowed in respect of expenditure incurred relating to income which does not form part of total income. A controversy has arisen as to whether disallowance can be made by invoking section 14A even in those cases where no income has been earned by an assessee, which has been claimed as exempt during the financial year.

The CBDT has, through this Circular, clarified that the legislative intent is to allow only that expenditure which is relatable to earning of income. Therefore, it follows that the expenses which are relatable to earning of exempt income have to be considered for disallowance, irrespective of the fact whether such income has been earned during the financial year or not.

The above position is clarified by the usage of the term “includible” in the heading to section 14A [Expenditure incurred in relation to income not includible in total income] and Rule 8D [Method for determining amount of expenditure in relation to income not includible in total income], which indicates that it is not necessary that exempt income should necessarily be included in a particular year’s income, for triggering disallowance. Also, the terminology used in section 14A is “income under the Act” and not “income of the year”, which again indicates that it is not material that the assessee should have earned such income during the financial year under consideration.

SIGNIFICANT NOTIFICATIONS/CIRCULARS

1. **Notification of foreign company for claiming exemption under section 10(48) [Notification No. 64/2013, dated 19.08.2013]**

Income received by a foreign company in India in Indian currency from sale of crude oil, any other goods or rendering of services, as may be notified by the Central Government in this behalf, to any person in India is exempt under section 10(48). For this purpose, the foreign company, as well as the arrangement or agreement, should be notified by the Central Government having regard to the national interest. The foreign company should not be engaged in any other activity in India, except receipt of income under such arrangement or agreement.

Accordingly, vide this notification, the Central Government, having regard to the national interest, has notified for the purposes of the said clause, the National Iranian Oil Company, as the foreign company and the Memorandum of Understanding entered between the Government of India in the Ministry of Petroleum and Natural Gas and the Central Bank of Iran on the 20th January, 2013, as the agreement subject to the condition that the said foreign company shall not engage in any activity in India , other than the receipt of income under the agreement aforesaid.

The Notification is deemed to be effective from 20th January, 2013.

In effect, section 14A read along with Rule 8D provides for disallowance of expenditure even where the taxpayer has not earned any exempt income in a particular year.

4. Taxability of partner's share, where the income of the firm is exempt under Chapter III / deductible under Chapter VI-A [Circular No. 8/2014 dated 31.03.2014]

Section 10(2A) provides that a partner's share in the total income of a firm which is separately assessed as such shall not be included in computing the total income of the partner. In effect, a partner's share of profits in such firm is exempt from tax in his hands.

Sub-section (2A) was inserted in section 10 by the Finance Act, 1992 with effect from 1.4.1993 consequent to change in the scheme of taxation of partnership firms. Since A.Y.1993-94, a firm is assessed as such and is liable to pay tax on its total income. A partner is, therefore, not liable to tax once again on his share in the said total income.

An issue has arisen as to the amount which would be exempt in the hands of the partners of a partnership firm, in cases where the firm has claimed exemption/deduction under Chapter III or Chapter VI-A.

The CBDT has clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Therefore, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes Nil in the hands of the firm on account of any exemption or deduction available under the provisions of the Act.