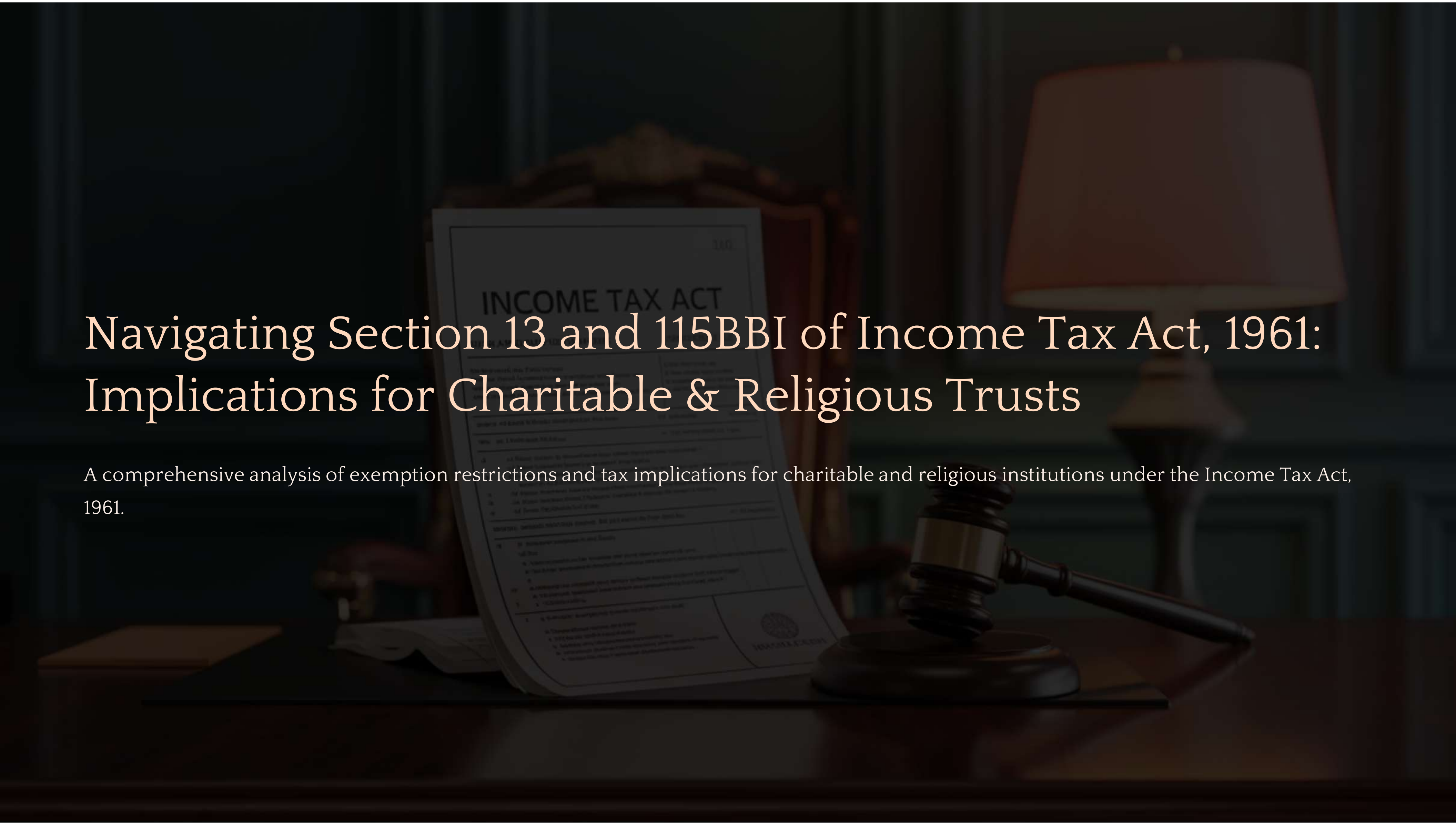


Navigating Section 13 and 115BBI of Income Tax Act, 1961: Implications for Charitable & Religious Trusts

A comprehensive analysis of exemption restrictions and tax implications for charitable and religious institutions under the Income Tax Act, 1961.

Agenda

Overview of Exemption Provisions

Understanding Section 11 exemptions for charitable and religious trusts

Section 13 Restrictions

Key conditions that lead to denial of tax exemptions

Section 115BBI

Tax implications on specified income of trusts

Interaction & Compliance

How these provisions work together and compliance requirements

This presentation aims to provide tax professionals and trustees with a clear understanding of the legal framework governing tax exemptions for charitable and religious institutions in India.

Legal Framework for Charitable Trusts

Foundational Provisions

- Section 11: Provides tax exemption for income from property held for charitable or religious purposes
- Section 12: Extends exemption to voluntary contributions received
- Section 13: Outlines restrictions on exemption eligibility
- Section 115BBI: Determines tax treatment of non-exempt income

The Income Tax Act provides a comprehensive regulatory framework to ensure that charitable and religious institutions operate within prescribed parameters while enjoying tax benefits.

Section 13(1): Primary Restrictions on Exemption

1. **Private Religious Trusts [Section 13(1)(b)]**

   Exemption under Section 11 is denied if the trust is established exclusively for the benefit of any particular religious community or caste.

2. **Benefit to Specified Persons [Section 13(1)(c)]**

   Exemption is forfeited if any part of the income or property is used directly or indirectly for the benefit of specified persons such as the author of the trust, trustees, or their relatives.

3. **Investment Restrictions [Section 13(1)(d)]**

   Income loses exemption if invested in modes other than those specified under Section 11(5), ensuring financial prudence and transparency.

Specified Persons Under Section 13(2)

Author of the Trust

The individual who established or founded the trust

Trustees & Managers

Persons responsible for trust administration and operations

Substantial Contributors

Any person who has contributed ₹1,00,000 or more to the trust

Relatives of Above Persons

Includes spouse, siblings, lineal ascendants and descendants

Prohibited Transactions with Specified Persons

Direct or Indirect Benefits

- Payment of excessive remuneration for services rendered
- Purchase of property for consideration exceeding market value
- Sale of trust property for inadequate consideration
- Diversion of income or property for personal use
- Loans without adequate interest or security
- Any monetary benefit beyond reasonable compensation

Judicial Precedent

The Supreme Court in CIT v. Bhagwan Dass Jain (2009) established that commercial transactions with interested persons must be at arm's length. Even minor deviations can trigger application of Section 13(1)(c).

Investment Restrictions Under Section 13(1)(d)

Deposits in Scheduled Banks

Savings, fixed deposits, and recurring deposits in scheduled banks

Post Office Schemes

Deposits in post office savings bank and other approved schemes

Government Securities

Central and state government securities and bonds

Immovable Property

Land, buildings, and other real estate assets

Approved Securities

Debentures and mutual funds as specified by the Board

Investments outside these prescribed modes result in forfeiture of exemption for the relevant income under Section 13(1)(d).

Anonymous Donations: Taxation and Exemptions

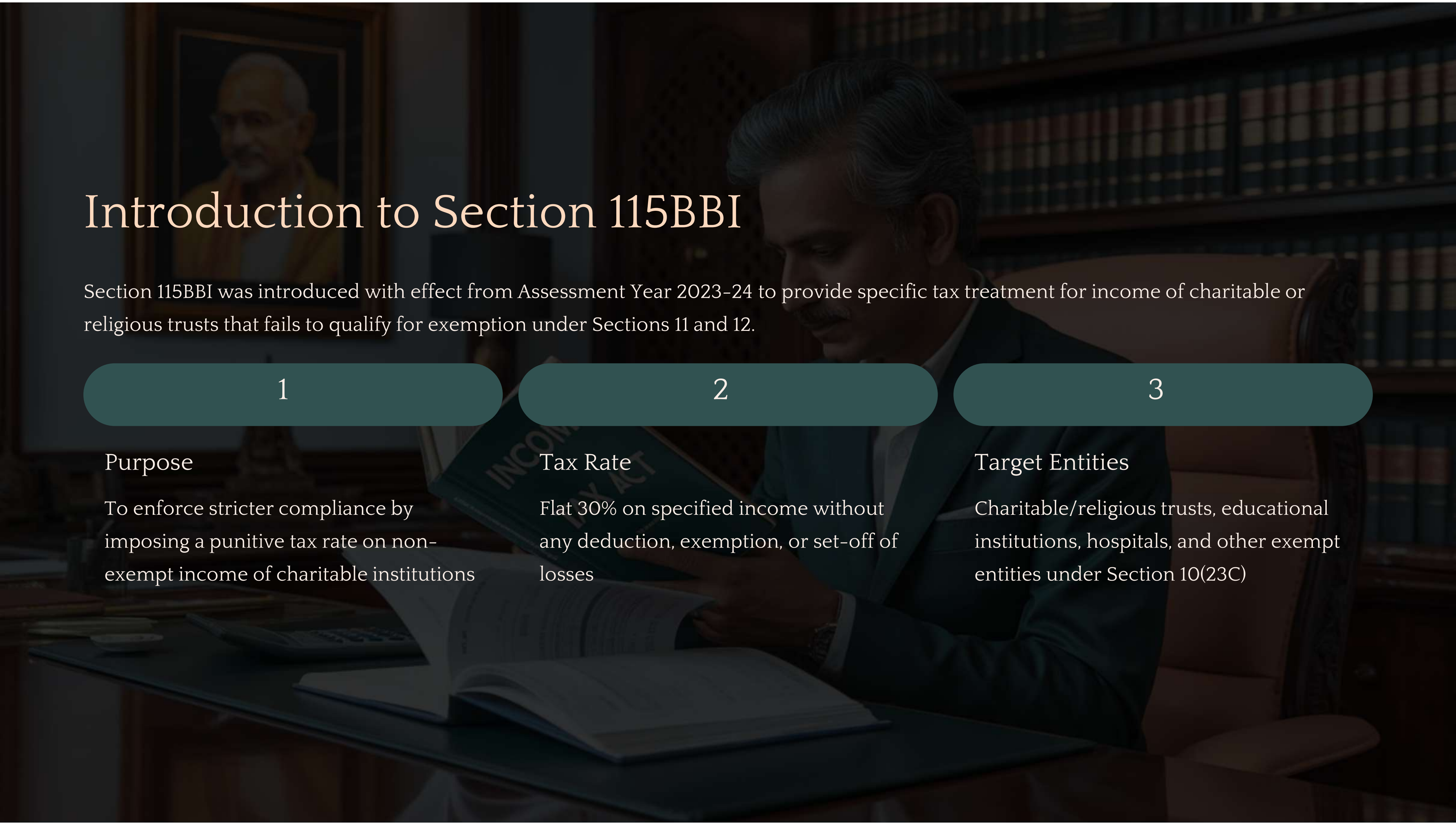
Definition and Treatment

Anonymous donations are voluntary contributions where the donor's identity cannot be established. These are subject to special taxation under Section 115BBC.

- Taxed at a flat rate of 30% plus applicable surcharge and cess
- Not eligible for exemption under Section 11
- Exemption allowed for 5% of total donations or ₹1,00,000, whichever is higher

Religious Trusts Exception

Anonymous donations to trusts established wholly for religious purposes are exempt from the provisions of Section 115BBC.



Introduction to Section 115BBI

Section 115BBI was introduced with effect from Assessment Year 2023-24 to provide specific tax treatment for income of charitable or religious trusts that fails to qualify for exemption under Sections 11 and 12.

1

Purpose

To enforce stricter compliance by imposing a punitive tax rate on non-exempt income of charitable institutions

2

Tax Rate

Flat 30% on specified income without any deduction, exemption, or set-off of losses

3

Target Entities

Charitable/religious trusts, educational institutions, hospitals, and other exempt entities under Section 10(23C)

Specified Income Under Section 115BBI

Excess Accumulation

Income accumulated beyond 15% without proper filing of Form 9A/10 or utilized improperly

Deemed Income

Income deemed taxable under Explanation 4 to third proviso of Section 10(23C) or under Section 11(1B)/11(3)

Condition Violations

Income losing exemption due to non-compliance with conditions under Section 10(23C) or violation of Section 13(1)(d)

Benefit to Specified Persons

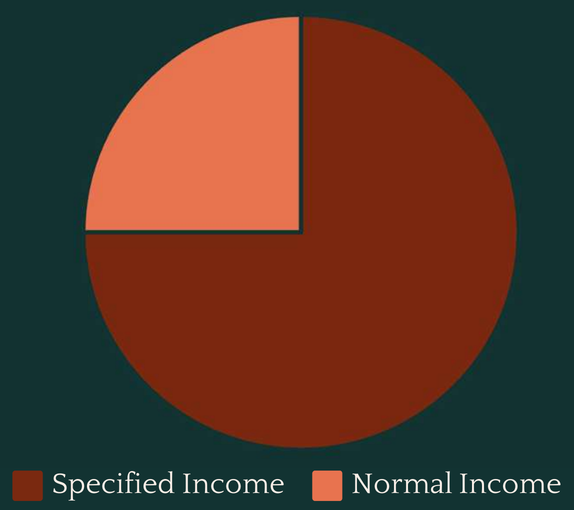
Income applied for the benefit of specified persons under Section 13(1)(c) that isn't excluded

Taxation Mechanism Under Section 115BBI

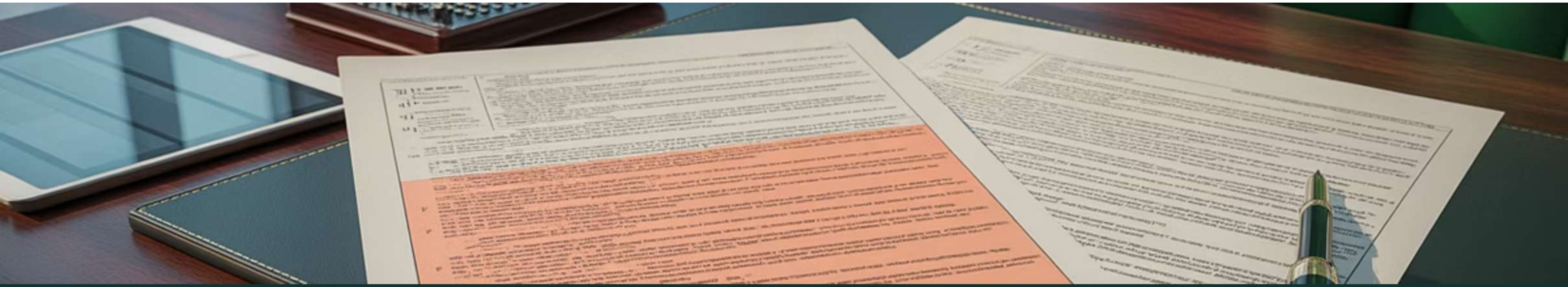
Two-Tier Taxation Structure

- Specified income: Taxed at flat 30% rate
- Remaining income: Taxed at normal applicable rates

No deductions, exemptions, or set-off of losses are permitted against income taxed under Section 115BBI. Additionally, the basic exemption limit of ₹2.5 lakh does not apply.



Illustrative tax rate comparison between specified income and normal income



Interaction Between Section 13 and Section 115BBI

1

Trigger Mechanism

Section 13 acts as the trigger by identifying conditions that lead to forfeiture of exemption under Section 11 or 12

2

Tax Determination

Section 115BBI prescribes the tax rate (30%) applicable to income that has lost exemption due to violations under Section 13

3

Compliance Enforcement

Together, these provisions create a robust framework that ensures stricter adherence to charitable purpose and prevents misuse of tax exemptions

Specific Violations and Tax Treatment

Violation	Section 13 Reference	Result	Tax under 115BBI
Trust benefits specific religious community/caste	13(1)(b)	Entire exemption lost	30% on total income
Income applied for benefit of specified persons	13(1)(c) & 13(2)	Exemption lost to extent of misuse	30% on misused income
Funds invested outside approved modes	13(1)(d)	Income from such investments not exempt	30% on non-compliant income
Excess anonymous donations	Section 115BBC	Treated as non-exempt	30% (under separate section)
Foreign application without approval	13 read with 11	Not allowed as application of income	30% on that income

Each violation triggers specific tax consequences, with Section 115BBI imposing a uniform 30% tax rate on the affected income.

Accumulation Provisions and Compliance Requirements

15% Rule and Accumulation

- Charitable trusts can accumulate up to 15% of income without restrictions
- Accumulation beyond 15% requires specific compliance
- Form 10 must be filed before the due date of filing return
- Form 9A required for income set aside for specific purposes

Penalty for Non-Compliance

Failure to file Form 10 or 9A within prescribed time limits results in entire accumulated income being taxed at 30% under Section 115BBI, with no deductions permitted.

Time Limits for Application of Accumulated Income

1. **End of Financial Year**

   Income earned during the financial year with option to accumulate beyond 15% with proper documentation

2. **Filing Forms 9A/10**

   Must be filed before the due date of return filing to validly accumulate income

3. **Subsequent 5 Years**

   Accumulated income must be applied for specified purposes within 5 years from the end of the year of accumulation

4. **Default Year**

   If not applied within specified period, becomes taxable at 30% under Section 115BBI in the year of default

Proper planning of accumulation and application is crucial to avoid punitive taxation under Section 115BBI.

Case Study: Application of Section 115BBI

Scenario

ABC Charitable Trust has total income of ₹1 crore for FY 2022-23. The trust:

- Paid ₹10 lakh as excessive salary to trustee's son
- Invested ₹20 lakh in non-specified securities
- Accumulated ₹30 lakh without filing Form 10
- Applied remaining ₹40 lakh for charitable purposes

Tax Calculation

Specified income under Section 115BBI:

- ₹10 lakh (benefit to specified person)
- ₹20 lakh (non-compliant investments)
- ₹30 lakh (improper accumulation)

Total specified income: ₹60 lakh

Tax under Section 115BBI: ₹60 lakh × 30% = ₹18 lakh

Only ₹40 lakh qualifies for exemption under Section 11

Judicial Interpretations on Section 13

CIT v. Bhagwan Dass Jain (2009)

Supreme Court held that transactions with interested persons must be at arm's length. Even minor deviations can trigger application of Section 13(1)(c).

CIT v. Nagpur Hotel Owners' Association (2001)

Bombay High Court ruled that incidental benefit to specified persons does not attract Section 13 if the primary purpose remains charitable.

DIT v. Sheth Mafatlal Gagalbhai Foundation Trust (2001)

Delhi High Court held that reasonable remuneration to trustees for professional services does not attract Section 13(1)(c).

CIT v. Sri Rama Charitable Trust (2008)

Karnataka High Court ruled that inadvertent technical violations should not result in denial of exemption if the trust has substantially complied with charitable objectives.

Preventive Measures for Compliance

Documentation and Record-Keeping

- Maintain detailed records of all transactions with specified persons
- Obtain independent valuation for property transactions
- Document rationale for remuneration and compensation decisions
- Keep evidence of market rates for comparable services
- Maintain investment registers with Section 11(5) classification

Governance Best Practices

- Establish independent compensation committee
- Implement conflict of interest policy
- Regular internal audits of compliance with Section 13
- Board approval for transactions with specified persons
- Timely filing of Forms 9A and 10 for accumulation

Recent Amendments and Implications

30%	2023-24	50%	100%
Tax Rate	Effective From	Potential Increase	Documentation
Flat rate applied to specified income under Section 115BBI	Assessment Year when Section 115BBI became applicable	In compliance costs for charitable trusts due to stricter regulations	Increase in documentation requirements for ensuring compliance

Recent amendments indicate a clear policy direction toward ensuring greater transparency and accountability in the functioning of charitable and religious trusts, with a focus on preventing misuse of tax exemptions.

Key Takeaways and Compliance Checklist

Critical Insights

- Section 13 and 115BBI work in tandem to enforce compliance
- Violations under Section 13 trigger punitive taxation under 115BBI
- Flat 30% tax rate applies to specified income with no deductions
- Transactions with specified persons require utmost scrutiny
- Investment restrictions must be strictly adhered to

Action Items

1. Review all transactions with specified persons for arm's length compliance
2. Ensure all investments comply with Section 11(5) requirements
3. File Forms 9A and 10 before due dates for proper accumulation
4. Implement robust governance measures to prevent inadvertent violations

Understanding and navigating the complex interplay between Section 13 and Section 115BBI is essential for trustees and tax professionals to ensure compliance and avoid punitive taxation.

THANK YOU

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