

GUIDANCE NOTE ON AUDIT OF PUBLIC CHARITABLE INSTITUTIONS UNDER THE INCOME-TAX ACT, 1961

[Based on the law as amended by the Finance Act, 2007]



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(Set up by an Act of Parliament)
NEW DELHI

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Website : www.icai.org

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First Edition : January, 2002

Second Edition : January, 2008

Price : Rs.150/-

ISBN No. : 978-81-8441-021-1

Published by : The Publication Department on behalf of CA. R. Devarajan, Secretary of Fiscal Laws Committee, The Institute of Chartered Accountants of India, C-1, Sector-1, Noida – 201 301.

Printed by : Sahitya Bhawan Publications, Hospital Road, Agra 282 003.
April/2008/3000 Copies

Foreword to the Second Edition

Since the publication of the first edition of the “Guidance Note on audit of public charitable institutions under the Income-tax Act, 1961” significant amendments have been made. A number of judicial decisions have also been rendered on the subject. Apart from this, some important audit related issues have arisen.

The Fiscal Laws Committee has thoroughly analysed all these developments and has come out with the second edition of the Guidance Note.

I compliment all the members of the Fiscal Laws Committee and particularly Mr. G. Ramaswamy, Chairman for their efforts in bringing out this edition.

Date: January 12, 2008

Place: New Delhi

CA. Sunil H. Talati
President

Preface to the Second Edition

The first edition of the “Guidance Note on audit of public charitable institutions under the Income-tax Act, 1961” was published in January, 2002. The Guidance Note gives guidance to members on audit of public charitable institutions under the Income-tax Act, 1961. Its sister publication “Taxation of charitable trusts and institutions – A Study” deals with the legal aspects of taxation of charitable trusts and institutions.

Since the publication of the first edition, significant amendments have been put on the statute book. The amendment relating to taxation of anonymous donations is very important. Several auditing and assurance standards have been prescribed by the ICAI. It has become necessary to give an idea about the Auditing and Assurance Standards relevant for audit of public charitable institutions under the Income-tax Act. Further, guidance has to be given in respect of medical and educational services made available to the specified category of persons and also the accountant’s responsibility in respect of anonymous donations. Apart from this, a number of judicial decisions have been rendered which had to be appropriately highlighted.

The Fiscal Laws Committee has thoroughly debated all these issues and has come out with the second revised edition.

I am thankful to CA. K.P. Garg for preparing the basic draft of this revised edition. I thank all the members of the Fiscal Laws Committee for ably seeing through the revised draft.

CA. Sunil H. Talati, President and CA. Ved Jain, Vice-President, have been the guiding force in this endeavour.

Finally, I appreciate the efforts of CA. R. Devarajan, Secretary, Fiscal Laws Committee, CA. Mukta Kathuria, Sr. Executive Officer for coordinating this project. Mr. Y.S. Rawat, Sr. Steno-Typist rendered secretarial assistance.

I am sure that this revised edition will be useful to the members.

Date: January 12, 2008

Place: New Delhi

CA. G.RAMASWAMY
CHAIRMAN
FISCAL LAWS COMMITTEE

Foreword to the First Edition

The law of taxation of charitable trusts and institutions is highly complex and has always been the subject matter of frequent amendments due to the fact that the medium of charitable institutions is widely perceived as a handy tool for tax planning. Recently the law relating to taxation of educational institutions and hospitals has undergone drastic changes and the Government is keen to bring all the charitable institutions claiming exemption of their income under the Income-tax Act into tighter scrutiny in the coming years.

The Taxation Committee published earlier “A Guide to Audit of Public Charitable Trusts under the Income-tax Act”. The Fiscal Laws Committee has thoroughly revised, expanded and upgraded this guide into a full-fledged Guidance Note on Audit of Public Charitable Institutions under the Income-tax Act. This guidance note brings out all the essential aspects of audit of charitable institutions under the Income-tax Act and will be of very great use to the members.

Apart from this, the Fiscal Laws Committee is also bringing a study, “Taxation of Charitable Trusts and Institutions” which deals with all the legal aspects of taxation of charitable trusts and institutions under the Income-tax Act.

The above publications, taken together, will be a comprehensive aid to the members for understanding the complex law of taxation and for adopting a uniform approach to the audit of public charitable institutions under the Income-tax Act.

I compliment all the members of the Fiscal Laws Committee and particularly Mr. Sunil Goyal, Chairman, Mr. T. N. Manoharan, Vice-Chairman and Mr. R. Bupathy for their efforts to see through this publication. I also wish to appreciate Mr. R. Devarajan, Secretary, Fiscal Laws Committee who has rendered competent technical assistance and also coordinated this project.

New Delhi
11th January, 2002

N.D. Gupta
President

Preface to the First Edition

The concept of charity has been in vogue in India for quite some time. Sections 11 to 13 of the Income-tax Act, 1961 contain the provisions for taxation and regulation of charitable institutions. Section 12A(b) of the said Act requires that where the total income of any charitable institution as computed under this Act, without giving effect to the provisions of section 11 and 12, exceeds Rs.50,000/- in any previous year, then the institution is required to get the accounts audited by a Chartered Accountant and furnish the audit report along with return of income. The law relating to charity has become very complex since its evolution and many controversial/debatable issues have arisen. Many changes have taken place in audit procedures also. Earlier the Institute had published a book titled as "A Guide to Audit of Public Charitable Trusts under the Income-tax Act" for the benefit of the members. It was decided that looking to the importance of the matter the same should be revised in two different publications. In the matter of audit, this present publication being Guidance Note on Audit of Public Charitable Institutions is being published for the guidance of the members for conducting audit under section 12A(b). This will be supplemented by another study being published by the Institute on Taxation of Charitable Trusts and Institutions.

I wish to extend my sincere thanks to Mr. M. Kandasami, FCA, Chennai, who prepared the basic draft of this publication.

I also wish to place on record my sincere thanks to the Vice Chairman and other members and invitees on the Fiscal Laws Committee for their wholehearted support and cooperation for the preparation of this guidance note.

I also sincerely thank the members of the Jaipur Study Group which under the convenership of Mr. O.P. Agarwal and co-convenership of Mr. Vijaykant Jain and Mr. Rajeev Sogani, were instrumental in giving the final shape to this guidance note.

I am also thankful to Mr. N.D. Gupta, President and Mr. A. K. Chandak, Vice-President of the Institute, for their encouragement and guidance in the publication of this guidance note.

I also want to place on record my sincere appreciation for Mr. R. Devarajan, Secretary to the committee for technical assistance and cooperation and Mr. Y.S. Rawat for the secretarial assistance rendered by them.

I am sure that this guidance note will be of great help to the members in discharging their onerous responsibility under section 12A(b) of the Income-tax Act.

Place: Jaipur
January 11, 2002

Sunil Goyal
Chairman
Fiscal Laws Committee

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**CLARIFICATION REGARDING AUTHORITY ATTACHED
TO THE DOCUMENTS ISSUED BY THE INSTITUTE**

"Guidance Notes' are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so. Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary".

(Volume I of the Compendium of Guidance Notes (4th Edition, 1993), page (x), Para 5)

Guidance Note on audit of public charitable institutions under the Income-tax Act, 1961

1. Introduction

- 1.1 Under section 11 of the Income-tax Act, 1961 certain incomes derived from property held under trust for charitable or religious purposes specified thereunder shall not be included in the total income of the previous year subject to the conditions prescribed by the Act
- 1.2 The person entitled to get exemption under section 11 of the Income-tax Act, 1961 may be a trust, society, company registered under section 25 of the Companies Act or any other legal obligation. For the purpose of brevity, in this guidance note such entities are referred to by the term "institution", without going into the fine distinctions that may exist between a "trust" and an "institution".
- 1.3 In order to get the exemption under section 11 of the Income-tax Act, 1961 such institutions should fulfill two conditions namely (i) the institution must be registered by the Commissioner on an application being made for registration by the institution in receipt of the income in accordance with the provisions of section 12A(1)(a) and (ii) in terms of section 12A(1)(b) where the total income of the person as computed under this Act without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the institution for that year should be audited by an accountant and the person in receipt of the income should furnish along with the return of income for the relevant assessment year the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.
- 1.4 The scope of this guidance note is restricted to the audit of the institutions prescribed under section 12A(1)(b). Such audit has been prescribed essentially to ensure compliance

with the provisions of sections 11 to 13. The nature of audit required under section 12A(1)(b) is similar to that of audit of general purpose financial statements. Hence, the accountant has to adopt the same procedures of audit as prescribed under Auditing and Assurance standards - **AASs** while certifying true and fair view shown by financial statements.

2. Objective of this Guidance Note

2.1 The object of this guidance note is to provide guidance to the accountants for discharging their responsibilities under section 12A(1)(b). It intends to;

- (i) assist in understanding the respective responsibilities of the institution and the accountant.
- (ii) guide the accountant as to the nature and scope of information to be obtained by him from the institution to enable him to conduct the audit.
- (iii) provide guidance on the verification procedures to be adopted by the accountant for giving the audit report and the necessary information in the annexure thereto.
- (iv) to give an idea about the various debatable issues relating to the law of taxation of public charitable institutions and
- (v) explain the circumstances where a disclosure or qualification or disclaimer may be required from the accountant while giving his audit report.

3. Terms, Abbreviations used in this Guidance Note

In this Guidance Note the following terms and abbreviations often occur in the text. A brief explanation of such terms and abbreviations is given below. Further, reference to a section without reference to the relevant Act means that the section has reference to the Income-tax Act, 1961.

- (a) Act**
The Income-tax Act, 1961.
 - (b) Accountant**
Accountant means a chartered accountant within the meaning of the Chartered Accountants Act, 1949, as referred to in section 288.
 - (c) AS**
Accounting Standards issued, prescribed and made mandatory by the Institute of Chartered Accountants of India.
 - (d) AS(IT)**
Accounting Standards notified by the Central Government under section 145(2).
 - (e) Board**
The Central Board of Direct Taxes constituted under the Central Boards of Revenue Act, 1963.
 - (f) Circular**
A circular or instruction issued by the Board under section 119(1) of the Income-tax Act, 1961.
 - (g) ICAI**
The Institute of Chartered Accountants of India.
 - (h) Rules**
The Income-tax Rules, 1962.
- 4. Responsibility of the institution**
- Ensuring compliance of the provisions of sections 11 to 13 is primarily the responsibility of the institution. For the purpose of audit under section 12A(b), the institution should prepare all the necessary information and particulars required under the relevant provisions to enable the accountant to verify and report in

accordance with the requirements of the Act. Further, such information and particulars should be duly authenticated by the competent authority governing the affairs of the institution. It would be advisable for the institution to take into consideration the following principles while preparing the necessary information and particulars;

- (a) it can rely upon the judicial pronouncements while taking any particular view about inclusion or exclusion of any items in the annexure to be furnished along with the report in Form No.10B.
- (b) if there is a conflict of judicial opinion on any particular issue it should refer to the view which has been followed while giving the relevant particulars.

The institution should also make available to the accountant all the books of account, records and other documents as may be deemed necessary by the accountant for carrying out the audit.

5. Accountant's responsibility

- 5.1 The audit report under section 12A(1)(b) is required to be given in Form No.10B prescribed under rule 17B, which requires the accountant to give his opinion whether to the best of his information and according to the information given to him the accounts give a true and fair view. Further, he has to annex the prescribed particulars.
- 5.2 The principal aim of this audit is to enable the Assessing Officer to satisfy himself about the genuineness of the claim for exemption under section 11 and also whether the institution has complied with all the requirements prescribed by the statute. As such the accountant should take care to see that there is compliance with the provisions of the Act to enable the Assessing Officer to satisfy himself about the genuineness of the claim for exemption under section 11 made by the institution. The accountant should also satisfy

himself regarding compliance with the provisions of the Act by the institution in respect of maintenance of proper books of accounts, information and returns from branches and other relevant records. The accountant has to examine the balance sheet and the profit and loss and give an opinion whether they exhibit a true and fair view.

- 5.3 The accountant should note that the **AASs** issued by the ICAI would be applicable to the audit under section 12A(1)(b). A brief discussion in this regard can be found in paragraph 11. A list of **AASs** issued by the ICAI is given in **Annexure III**.
- 5.4 As in the case of other professional assignments, the accountant should comply with the “Code of Ethics” issued by the ICAI in conducting the audit under section 12A(1)(b). The accountant is advised to conduct the audit under section 12A(1)(b) in accordance with this guidance note.

6. Audit – when required

- 6.1 Clause (b) of sub-section (1) of section 12A of the Act requires audit if the “total income” of the institution for the relevant year exceeds the maximum amount which is not chargeable to income tax. This means if the total income of the institution in any previous year before giving effect to the provisions of the Act is less than the maximum amount which is not chargeable to income tax, then audit under the Act is not required. It is significant to note that contributions made with a specific direction that they shall form part of the corpus of the institution is included in the definition of income under section 2(24). However, by virtue of section 11(1)(d) they shall not be included in the total income of the previous year. The implications of the above provisions are that for determining the ceiling limit of the maximum amount which is not chargeable to income tax for the purpose of exigibility to audit under section 12A(1)(b), contributions towards the corpus of the institution are to be included. However, incomes exempt under section 10, e.g. dividends, are not to

be included for ascertaining whether the income exceeds the maximum amount which is not chargeable to income tax.

- 6.2 It is sometimes likely that on a computation made by the institution, the total income does not appear to exceed the limit of the maximum amount which is not chargeable to income tax. However, subsequently it may so transpire that the total income exceeds the maximum amount which is not chargeable to income tax on account of circumstances which were not known originally [e.g. accidental misapplication of the earmarked investments under section 11(2)(b)]. The section does not provide for such contingencies; but it would appear that in such cases the report on audit could be submitted with a revised return.
- 6.3 Some of the State legislations relating to trusts and charitable institutions may provide for compulsory audit even where the income is below the maximum amount which is not chargeable to income tax. Such ceiling limits have to be construed purely in terms of the statutory provisions of the relevant State Acts.
- 6.4 The donations received by an institution whose income are exempt under sections 11 and 12 or clause (23) or clause (23AA) or clause (23C) of section 10 of the Act are eligible for deduction under section 80G(2)(a) (iv) of the Act provided the institution is approved by the Director General (exemptions)/ Commissioner of Income-tax under section 80G(5)(vi). Certain conditions are to be fulfilled in order to claim the donations made to such an institution eligible for deduction under section 80G. Further, there is a prescribed procedure for getting the approval from the Director General (Exemptions) Commissioner of Income-tax.
- 6.5 For the purposes of audit prescribed under section 12A(1)(b), the accountant has to give his report in Form No.10B. Further, he has to annex certain particulars mentioned in the Annexure to the above Form No.10B.

- 6.6 This guidance note primarily deals with the duties of the accountant in the context of the requirements of sections 11 to 13. The primary responsibility of the accountant who is required to do the audit in terms of section 12A is with reference to the provisions of the Act which is a self contained code by itself. Strictly speaking, unless there is a specific requirement in the Act itself or under any rule/form prescribed thereunder requiring the auditor to verify certain matters in relation to other laws, there is no duty cast upon the accountant to verify or certify about the compliance with the provisions of any other law. However, if the non-compliance with the provisions of any other law would lead to the contravention of the provisions of the Act in so far as it relates to audit under section 12A and affects the truth and fairness thereof, then alone it is the duty of the accountant to verify the compliance with the provisions of other law(s). Therefore, the accountant may verify whether the institution has complied with the requirements of laws like Foreign Contributions Regulation Act, 1976, Societies Registration Act, 1860 etc. having regard to the truth and fairness of the financial statements. Some useful particulars regarding these allied legislations are given in **Annexure VII**. Further, the requirements of AAS-21 as mentioned in paragraph 11.21 have to be duly complied with.
- 6.7 Apart from the requirements as to audit of institutions as contained in section 12A(1)(b), there are other relevant requirements like registration of such institutions. Section 12A(1)(a) deals with the conditions regarding registration of an institution under the Act. On being registered, the institution will get the benefit of exemption of its income under the provisions of section 11 provided it complies with the prescribed statutory requirements. The application for registration has to be made in Form No.10A in duplicate, which is prescribed under Rule 17A of the Rules. A detailed treatment of the law applicable in respect of exemption of income of such institutions can be found in the publication of

ICAI “Taxation of educational and charitable institutions under the Income-tax Act, 1961”.

7. Relevant statutory provisions and rules

- 7.1 Section 2(15) defines charitable purpose. Section 2(24)(ii) provided earlier that contributions made with a specific direction that they shall form part of the corpus of the institution was not to be included in income. This provision was amended with effect from 1.4.1989, so as to include in the definition of income all voluntary contributions. Sections 11, 12, 12A, 12AA, and 13 come within the scope of Chapter III of the Act contain the provisions relating to exemption of income from property held for charitable or religious purposes. Section 11 specifies the types of income exempt in the hands of public charitable institutions, section 12 deals with income of trusts or institutions from contributions, section 12A contains the condition as to registration of trust etc., section 12AA prescribes the procedure for registration and section 13 enumerates the circumstances to which the exemption provisions of section 11 would not apply.
- 7.2 Any income referred to in sub-section (2) of section 11 which is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10 shall be deemed to be the income of such person of the previous year in which it is so credited or paid or of the previous year immediately following the expiry of the period aforesaid.
- 7.3 Sub-section (2) of section 12 provides that the value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or any educational institution, to any person referred to in clause (a) or clause (b) or clause (c) or clause (cc) or clause (d) of sub-section (3) of section 13, shall be deemed to be income of such trust or institution

derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income tax not withstanding the provisions of sub-section (1) of section 11.

- 7.4 Anonymous donations: From 1-4-2007, relevant to assessment year 2007-08 a new section 115BBC has been inserted to provide that contributions received by way of anonymous donations by any trust or institution referred to in section 11 will be included in the total income and taxed at the rate of 30 per cent. However exception has been provided for anonymous donation received by -
- (a) any trust or institution created or established wholly for religious purpose:
 - (b) any trust or institution created or established wholly for religious and charitable purposes other than any anonymous donation made with a specific direction that such donation is for any university or other education institution or any hospital or other medical institution run by such trust or institution.

“Anonymous donation” has been defined to mean any voluntary contribution referred to in sub-clause (iia) of clause (24) of section 2, where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

- 7.5 Sub-section (7) of section 13 provides that nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donations referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.
- 7.6 Rules 17, 17A, 17B and 17C are the relevant rules and Form No.10, and Form No.10B are the relevant forms.

7.7 The text of the relevant statutory provisions is given in **Annexure I**. The text of the relevant rules and Form No.10 are given in **Annexure II**. Text of Form No.10B is given in paragraph 13.

8. Charitable purpose

8.1 The Income-tax Act does not define charity. However, sub-section (15) of section 2 defines “charitable purpose”. Accordingly, “charitable purpose” includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility.

8.2 The definition of “charitable purpose” includes “any other object of general public utility”. The question arises as to what is an object of “general public utility”. This expression has not been defined anywhere in the Act.

8.3 Judicial authorities have laid down that it is the intrinsic object of the trust and the scope of its benefit to the public which should be the guiding consideration in coming to a conclusion whether an institution is established for a charitable purpose. It has also been held that objects which exclude private gains, which are unselfish and are devoted to public benefit or are philanthropic, that is to say, dictated by a desire to do good to the public are charitable purposes.

8.4 Charitable purposes and objects of general public utility embrace a wide range. It is not necessary that such objects should directly benefit the entire community, but it is quite sufficient if a substantial portion of the community benefits therefrom.

8.5 The Hon'ble Supreme Court in the case of *CIT v. Andhra Chamber of Commerce [1965] 55 ITR 722 (SC)* held that the advancement or promotion of trade, commerce and industry leading to economic prosperity enured for the benefit of the entire community. That prosperity would be shared also by those who were engaged in a trade, commerce and industry. In such condition also the property was held to be used for general public utility. So, when the principal object of a

chamber of commerce was to promote and protect trade, commerce and industry in India or any part thereof, the Supreme Court held that the said object was of general public utility. Similar views were reiterated by Hon'ble Supreme Court in the case of *Surat Art Silk Cloth Manufacturers Association (1980) 121 ITR 1 (SC)*.

- 8.6 In the above noted case the Hon'ble Supreme Court laid down the following general principles to determine when a purpose would become charitable.

“Charitable purpose” includes not only relief of the poor, education and medical relief alone, but advancement of other objects of general public utility as well. Section 2(15) is intended to serve as a special definition of the expression “charitable purpose” for the Act. It is again inclusive and not exhaustive. Even if the object or purpose may not be regarded as charitable in its popular signification as not intended to give relief to the poor or for the advancement of education or medical relief, it should still be included in the expression “charitable purpose”, if it advances an object of general public utility. The expression “objects of general public utility”, however, is not restricted to objects beneficial to the whole of mankind. An object beneficial to a section of the public could also be treated as an object of general public utility. To serve a charitable purpose, it is not necessary that the object should be to benefit the whole of mankind or even all persons living in a particular country or province. It is sufficient if the intention is to benefit a section of the public as distinguished from specified individuals. The section of the community sought to be benefitted must be undoubtedly defined and identifiable by some common quality of a public or impersonal nature. Where there is no common quality of a public or impersonal nature; where there is no common quality uniting potential beneficiaries into a class, it may not be regarded as charitable.”

- 8.7 The Bombay High Court held in *Bar Council of Maharashtra v. CIT [1980] 126 ITR 27 (Bom.)* that the word “general” in

section 2(15) means pertaining to a whole class, the word 'public' means the body of people at large and the word "utility" means usefulness. Thus the advancement of any object beneficial to the public or section of the public as distinguished from an individual or group of individuals would be a charitable purpose. The State Bar Council was held to be a body constituted for general public utility and its income would be entitled to exemption under section 11. The Supreme Court affirmed the decision of the High Court when the case came up in appeal in *CIT v. Bar Council of Maharashtra* [1981] 130 ITR 28 (SC).

8.8 Further, the judicial decisions on the scope of the term "charitable purpose" and other related matters are given in **Annexure IV**.

9. Scope of audit under section 12A(1)(B)

9.1 Under the provisions of sub-clause (b) of sub-section (1) of section 12A, where the total income of the trust or institution as computed under the Act without giving effect to the provisions of sections 11 and 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year, the accounts of the trust or institution for that year should be audited by an accountant as defined in the Explanation below sub-section (2) of section 288 and the person in receipt of the income should furnish along with the return of income for the relevant assessment year the report of such audit in the prescribed form duly signed and verified by such accountant and setting fourth such particulars as may be prescribed. The report is to be given by an accountant in Form No. 10B as prescribed under rule 17A. The accountant is required to state whether he has examined the balance sheet of the institution as at the relevant date and the profit and loss account for the year ended on that date which are in agreement with the books of account maintained by the said institution. He has to further state whether he has obtained all the information and explanations which to the best of his knowledge and belief were necessary

for the purposes of the audit. He has to give his opinion whether proper books of account have been kept by the head office and the branches of the institution visited by the accountant so far as appears from his examination of the books. He has also to give his opinion whether proper returns adequate for the purposes of audit have been received from branches not visited by him. If he has any comments to offer about the information and explanations, proper books of account or returns from branches, he has to state such comments in the body of the audit report. He has to give his opinion whether to the best of his information and according to the information given to him the said accounts give a true and fair view shown in financial statements. Lastly, he has to state that the prescribed particulars are annexed thereto. In this connection the requirements of **AAS 28 – The Auditor’s Report on Financial Statements** should be kept in mind. The purpose of this AAS is to establish standards on the form and content of the auditor’s report issued as a result of an audit performed by an auditor of the financial statements of an entity. The standard prescribes many requirements like that the auditor should review and assess the conclusions drawn from the audit evidence as the basis for the expression of an opinion on the financial statements, the auditor’s report should contain a clear written expression of an opinion on the financial statements taken as a whole etc.

- 9.2 In giving his report the accountant will have to use his professional skill and expertise and apply such audit tests as the circumstances of the case may require, considering the contents of the audit report. He will have to conduct the audit by applying the generally accepted auditing procedures, which are applicable for any other audit. He can apply the test checks depending on the evaluation of internal control procedures followed by the assessee. The accountant will also have to keep in mind the concept of materiality depending upon the circumstances of each case.

9.3 The audit report given under this section is to assist the income-tax department to verify whether the assessee has complied with the provisions of sections 11 to 13 of the Act. In order that the accountant may be in a position to explain any question which may arise later on, it is necessary that he should keep detailed notes about the evidence on which he has relied upon while conducting the audit and also maintain all his working papers. Such working papers should include his notes on the following, amongst other matters:

- (a) work done while conducting the audit and by whom;
- (b) explanation and information given to him during the course of the audit and by whom;
- (c) decision on the various points taken;
- (d) the judicial pronouncements relied upon by him while drafting the audit report; and
- (e) certificates issued by the client / management letters.

The audit under section 12A(1)(b) of the Act falls under the Attestation Engagement and thus is covered by the Statement of Peer Review. Accordingly, all requirements laid down in the Statement including documentation are applicable.

9.4 It is important that the audit working papers prepared and / or obtained by the accountant provide evidence that:

- (i) the opinion expressed by the accountant in respect of the particulars furnished in the Annexure is based on the examination made by him;
- (ii) in arriving at his opinion, the accountant has given due cognizance to the information and explanations given by the assessee and that his opinion is not arbitrary;

- (iii) the information and explanations obtained were full and complete that is, the accountant has called for all the information and explanations which were necessary to be considered before arriving at his opinion; and
- (iv) the accountant did not merely rely upon the information or explanations given by the assessee but that he subjected such information and explanations to reasonable tests to verify their accuracy and completeness.

- 9.5 The form of audit report requires the accountant to examine the balance sheet and the profit and loss account of the institution. Perhaps, the nomenclature "profit and loss account" may be less appropriate in relation to an institution where, on account of lack of profit motive the income statement is more commonly designated as "income and expenditure account". However, the auditor's report in form 10B specifies "profit and loss account" and as such it would only be appropriate in all cases to designate the same as profit and loss account. Apart from this, since section 11(4A) permits a trust or a charitable institution to carry on business, profit and loss account and balance sheet have to be prepared in respect of such business.
- 9.6 The accountant has to examine the balance sheet and the profit and loss account of the institution in the light of information and explanations and various branch returns and give an opinion whether they exhibit a true and fair view. In this respect the audit under section 12A(1)(b) can be equated to an audit of general purpose financial statements.
- 9.7 If the institution is constituted in the form of a company registered under section 25 of the Companies Act, 1956, it is possible that prior to the audit under section 12A(1)(b), statutory audit under the Companies Act may have been completed. The accountant may rely on the above statutory audit report to such extent and in such manner as provided in ***AAS 10 – Using the work of another auditor.***

9.8 It may be noted that mere filing of the audit report under section 12A(1)(b) may not fulfill the requirement of filing tax audit report in appropriate cases. For example, where an institution is carrying on a business whose objects are incidental to the attainment of the objectives of the institution and separate books are maintained in respect of such business, audit under section 44AB of the Act may become necessary if the sales, turnover or gross receipts from such business exceed Rs.40 lakhs. In that case the institution has to get its accounts audited under section 44AB and furnish the audit report along with return of income before the specified date.

10. Accounting standards

10.1 Accounting Standards apply in respect of commercial, industrial or business activity of any enterprise, irrespective of whether it is profit oriented or is established for further charitable or religious purposes. In the case of an institution, AS will not apply if all activities of such institutions are not of commercial, industrial or business nature (e.g. an activity of collecting donations and giving them to flood affected people). In other words, exclusion of an institution from the applicability of the AS would be permissible only if no part of the activity of such institution is commercial, industrial or business in nature. Even if a very small portion of the activities of an institution is considered to be commercial, industrial or business in nature, then it cannot claim exemption from the application of AS. The AS would apply to all its activities including those which are not commercial, industrial or business in nature. This fundamental principle of applicability of AS is equally valid in respect of institutions also. Further, the Government has notified AS (IT) under sub-section (2) of section 145. AS (IT) are applicable to all the assesseees maintaining their accounts on mercantile basis, if they carry on a business.

11. Compliance with Auditing and Assurance Standards

As the audit report under section 12A(1)(b) is an expression of opinion about the truth and fairness of general purpose financial statement, the accountant is advised to follow all Auditing and Assurance Standards. The following is a brief summary of the AASs issued by the ICAI.

11.1 AAS 1 : *Basic Principles Governing an Audit*

This Auditing and Assurance Standard was the first standard on auditing issued by the Institute. As the name suggests, it seeks to lay down and briefly explain the basic principles which govern the auditor's professional responsibilities and which should be complied with whenever an audit is carried out. These principles are, namely, integrity, objectivity and independence, confidentiality, skills and competence, work performed by others, documentation, planning, audit evidence, accounting system and internal control, and, finally, audit conclusions and reporting.

11.2 AAS 2 : *Objective and Scope of the Audit of Financial Statements*

This Standard describes the overall objective and scope of the audit of general purpose financial statements of an enterprise by an independent auditor. The Standards deals with the following important aspects of an audit:

Objective of an Audit: expression of opinion, the concept of true and fair view.

Responsibility for Financial Statements: responsibility of the management *vis a vis* auditor.

Scope of Audit: factors determining scope, reliability and sufficiency of audit evidence, disclosure aspects, undiscovered material misstatements, etc.

11.3 AAS 3 : *Documentation*

This Standard was issued with the purpose of amplifying the basic principle that the auditor should document matters

which are important in providing evidence that the audit was carried out in accordance with the generally accepted auditing standards in India. The Standard explains as to what constitute working papers, need for working papers. The Standard also touches upon the following areas:

- Form and Content: factors affecting form and content, quantum of working papers, permanent audit file, current audit file.
- Ownership and Custody of Working Papers

11.4 *AAS 4 (Revised) : The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements*

As the name indicates, the purpose of this AAS is to establish standards on the auditor's responsibility to consider fraud and error in an audit of financial statements. The following gives an overview of the contents of the AAS:

- Fraud and error and their characteristics
- Responsibility of those charged with governance
- Responsibility of management
- Responsibility of the auditor
- Indication of possible misstatement
- Evaluation and disposition of misstatements.
- Effect on auditor's report
- Documentation
- Management representations
- Communication
- Auditor unable to complete engagement

The appendices to the AAS contain examples of risk factors relating to misstatements resulting from fraud/error, examples of modifications in auditor's procedures, and indicators of possible fraud or error.

11.5 *AAS 5 : Audit Evidence*

The purpose of this AAS is to establish standards on the basic principle that the auditor should obtain sufficient appropriate audit evidence through compliance and substantive procedures to enable him to draw reasonable conclusions there from on which to base his opinion on the financial information. The AAS also explains the concept of sufficient appropriate audit evidence, factors affecting it as also the various types of assertions, internal vis-à-vis external evidence. The Standard also deals with the methods of obtaining evidence, namely, inspection, observation, inquiry and confirmation, computation and analytical review.

11.6 *AAS 6 : Risk Assessments and Internal Control*

The purpose of this AAS is to establish Standards on the procedures to be followed to obtain an understanding of the accounting and internal control systems and on audit risk and its components: inherent risk, control risk and detection risk. The standard also extensively deals with aspects such as meaning of audit risk and its three components, meaning and inherent limitations of accounting and internal control systems, control environment, control risk and its assessment, tests of control, assessment of inherent risk and its relationship with control risk, assessment of detection risk, audit risk in small business and communication of weaknesses.

11.7 *AAS 7 : Relying Upon the Work of an Internal Auditor*

The AAS establishes standards on the procedures that should be adopted by the external auditor to assess the work of an internal auditor for placing reliance upon that work. The Standard touches upon topics like scope and objective of internal audit function, relationship between internal and external auditor, aspects to be considered in evaluating the internal audit function, coordination between internal and external auditor, evaluating specific internal audit work.

11.8 *AAS 8 : Audit Planning*

The basic objective of the AAS is to establish standards on the principle that the auditor should plan his work to enable him to conduct an effective audit in an efficient manner and that the plan should be based on the knowledge of the client's business. The AAS covers topics such as advantages of audit planning, sources of obtaining knowledge of the client's business, topics on which discussion with client might be useful, factors to consider in development of an overall plan, developing an audit programme etc.

11.9 *AAS 9 : Using the Work of an Expert*

This AAS discusses the auditor's responsibility in relation to, and the procedures the auditor should consider in, using the work of an expert as audit evidence. The AAS explains the concept of an 'expert', situations in which the need for using the work of an expert might arise, factors to consider when deciding whether to use the work of an expert or not, evaluating the skills and competence and objectivity of an expert, procedures for evaluating the work of an expert, references to an expert auditor's report, etc.

11.10 *AAS 10 : Using the Work of Another Auditor (Revised)*

This AAS discusses the procedures to be applied in situations where an independent auditor (principal auditor) reporting on the financial statements of the entity uses the work of another auditor (other auditor) with respect to the financial statements of one or more components included in the financial statements of the entity. The AAS explains the concept of component. It also deals in detail with the procedures to be adopted by the principal auditor when using the work of the 'other auditor', need for evaluating the professional competence of the 'other' auditor, documentation, coordination between principal and other auditor, reporting considerations for the principal auditor, and division of responsibility.

11.11 *AAS 11 : Representations by Management*

The AAS was issued to establish standards on the use of management representations as audit evidence, the procedures to be applied in evaluating and documenting management representations, and the action to be taken if management refuses to provide appropriate representations. The Standard touches upon topics including situations in which the auditor should obtain management representations, management representation *vis a vis* other audit evidence, documentation of such representations, types of management representations, basic elements of management representation letters, etc. The Standard also contains example of a management representation letter on the different elements of the financial statements

11.12 *AAS 12 : Responsibility of Joint Auditors*

The practice of appointing more than one auditor to conduct the audit of large entities has been in vogue for a long time. Such auditors, known as joint auditors, conduct the audit jointly and report on the financial statements of the entity. This AAS deals with the professional responsibilities which the auditors undertake in accepting such appointments as joint auditors. The important aspect of joint audit assignments as covered by this AAS include possible bases of division of work among joint auditors, coordination among joint auditors, joint and several liability of joint auditors, responsibility for obtaining and evaluating information and explanation from management, responsibility for scrutiny of branch accounts and returns, need for review of work performed by one joint auditor by other joint auditor(s), reporting responsibilities etc.

11.13 *AAS 13 : Audit Materiality*

Information is material if its misstatement (i.e., omission or erroneous statement) could influence the economic decisions of users taken on the basis of the financial information. Materiality provides a cut off point rather than being a primary

qualitative characteristics which the information must have if it is to be useful. This AAS establishes standards on the concept of materiality and its relationship with audit risk. Accordingly, the AAS deals with aspects such as establishment of acceptable materiality levels, relationship between materiality and audit risk, procedures to reduce audit risk, materiality and audit risk in evaluating audit evidence, components of aggregate of uncorrected misstatements and auditor's plan of action, review of materiality level and subsequent changes therein, etc.

11.14 *AAS 14 : Analytical Procedures*

"Analytical procedures" means the analysis of significant ratios and trends, including resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts. The purpose of this AAS is to establish standards on the application of analytical procedures during an audit. The AAS, accordingly, deals with aspects like nature and purpose of analytical procedures, analytical procedures in planning the audit, analytical procedures as substantive procedures, analytical procedures in the overall review at the end of the audit, extent of reliance on analytical procedures, investigating unusual items etc.

11.15 *AAS 15 : Audit Sampling*

"Audit Sampling" means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditor to obtain and evaluate audit evidence about some characteristics of the items selected in order to form or assist in forming a conclusion concerning the population. The purpose of AAS is to establish standards on the design and selection of an audit sample and the evaluation of sample results and applies equally to statistical and non-statistical sampling. The areas covered by the AAS include design of sample, audit objectives, population, stratification, sample size and risk, tolerable and expected error, selection of sample,

evaluation of sample results, analysis of errors in the sample, projection of errors, reassessing sampling risk.

11.16 *AAS 16 : Going Concern*

As members are aware, “going concern” is one of the fundamental assumptions underlying the preparation of the financial statements. The objective of this AAS is to establish standards on the auditor’s responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as the basis for the preparation of the financial statements. The AAS deals with the relevant areas in this regard such as indications – financial, operating and other - of appropriateness or otherwise of the going concern assumption, audit evidence, illustrative audit conclusions and reporting in case going concern assumption considered appropriate/ going concern question not resolved/ going concern assumption considered inappropriate.

11.17 *AAS 17 : Quality Control for Audit Work*

The purpose of this Standard is to establish standards on quality control policies and procedures of an audit firm regarding audit work generally; and procedures regarding the work delegated to assistants on an individual audit. The AAS deals with the such aspects of the quality control for audit work, namely, objectives of the quality control policies to be adopted by audit firm, direction to be provided to the assistants to whom work has been delegated, supervision of the work being performed by the assistants, review of the work being performed by assistants and factors to be considered therein.

11.18 *AAS 18 : Audit of Accounting Estimates*

Accounting Estimates means an approximation of the amount of an item in the absence of a precise means of measurement. This AAS, as the name suggests, establishes standards on the audit of accounting estimates. The AAS, accordingly, deals with such aspects, including, nature of accounting estimates, audit procedures, reviewing and

testing the process used by management, evaluation of data and consideration of assumptions, testing of calculations, comparison of previous estimates with actual results, use of independent estimates, review of subsequent events, evaluation of results of audit procedures.

11.19 *AAS 19 : Subsequent Events*

Subsequent events refer to significant events occurring between the balance sheet date and the date of the auditor's report. This AAS lays down the responsibility of the auditor in respect of subsequent events. It also provides the audit procedures for identification of relevant subsequent events, for example, reading minutes, reviewing management procedures, inquiries of management and other concerned persons etc. the Standard also guides the auditor on his reporting responsibilities in respect of subsequent events.

The AAS is effective for all audits commencing on or after April 1, 2000.

11.20 *AAS 20 : Knowledge of the Business*

This Standard establishes standards on what is knowledge of the business, why it is important to the auditor, and to the audit staff working on an engagement. It also establishes standards on why knowledge of the business is relevant to all phases of an audit and how the auditor obtains and uses that knowledge. The AAS therefore deals with the relevant topics such as, obtaining knowledge of the business before and after accepting the assignment, sources of knowledge, using the knowledge, areas affected by the knowledge of the client's business etc.

11.21 *AAS 21 : Consideration of Laws and Regulations in an Audit of Financial Statements*

This AAS lays down standards on auditor's responsibility regarding consideration of laws and regulations in an audit of financial statements. The AAS therefore deals with aspects such as responsibility of the management for compliance with laws and regulations, auditor's consideration of

compliance with laws and regulations, audit procedures where non compliance is discovered, communicating/reporting non compliance to management/users of audited financial statements/ regulators, and situations for withdrawal from engagement. The Appendix to the AAS contains indications that non compliance might have occurred.

11.22 *AAS 22 : Initial Engagements – Opening Balances*

“Initial engagements” mean when the financial statements are audited for the first time or when the financial statements for the preceding period were audited by another auditor. “Opening balances” means those account balances which exist at the beginning of the period. This AAS establishes standards regarding audit of opening balances in case of initial engagements. The Standard, therefore, deals with audit procedures for obtaining sufficient appropriate evidence in respect of opening balances. The Standard also provides guidance to the auditors on situations warranting qualified opinion/ disclaimer of opinion.

11.23 *AAS 23 : Related Parties*

The Institute had issued Accounting Standard (AS) 18 on Related Party Disclosures. The purpose of this AAS is to lay standards on auditor’s responsibilities and audit procedures regarding related parties and related party transaction, as defined in AS 18. The AAS covers areas including, existence and disclosure of related parties, transactions with related parties, examining unidentified related party transactions, management representations, audit conclusions and reporting. The appendix to AAS contains an illustrative management representation letter regarding related parties.

11.24 *AAS 24 : Audit Considerations relating to Entities Using Service Organisations*

This AAS lays down standards for an auditor whose client uses a service organisation. This AAS also describes the reports of the auditors of the service organisation which may be obtained by the auditor of the client. The AAS therefore

first explains the concept of a “service organisation” and then goes on to describe the considerations for the auditor of the client, factors to be considered in determining the significance of the activities of the service organisation to the client and their relevance to audit, obtaining necessary information from service organisations, auditor’s procedures in case such information is insufficient etc.

11.25 *AAS 25 : Comparatives*

The purpose of this Auditing and Assurance Standard (AAS) is to establish standards on the auditor’s responsibilities regarding comparatives. It does not however deal with situations when summarized financial statements or data are presented with the audited financial statements. The AAS therefore explains the concept of comparatives in financial statements, corresponding figures and comparative financial statements. It also deals with the requirement for obtaining sufficient appropriate audit evidence in respect of comparatives, audit procedures where prior period financial statements are unaudited, audit procedures in case of material misstatements in comparatives or where prior period audit report contains a modified opinion, etc. The AAS also contains a discussion on financial reporting frameworks for comparatives and also illustrative auditor’s report in circumstances described in the Standard.

11.26 *AAS 26 : Terms of Audit Engagement*

This AAS establishes standards on agreeing to the terms of engagement with the client and the auditor’s response to a request by client to change the terms of an engagement to one that provides lower level of assurance. The AAS discusses principal contents of an audit engagement letter, audit engagement letter in case of audit of components, factors affecting audit engagement letter in case of recurring audits. The AAS also extensively deals with the duties and responsibilities of the auditors in case of a change in engagement.

11.27 *AAS 27 : Communications of Audit Matters with Those Charged with Governance*

The term “governance” as used in this AAS refers to the role of persons entrusted with the supervision, control and direction of an entity. “Those charged with governance” are ordinarily accountable for ensuring that the entity achieves its objectives, financial reporting, and reporting to interested parties. The AAS establishes standards on communications of audit matters arising from the audit of financial statements between the auditor and those charged with governance of an entity. The AAS therefore provides guidance to auditors as to procedures to identify relevant persons, what are the audit matters of general interest to be communicated, forms of communication, factors affecting communication, confidentiality requirements, laws and regulations etc.

11.28 *AAS 28 : The Auditor’s Report on Financial Statements*

The purpose of this AAS is to establish standards on the form and content of the auditor’s report issued as a result of an audit performed by an auditor of the financial statements of an entity. Much of the standards laid down by this AAS can be adapted to auditor’s reports on financial information other than financial statements. The AAS deals extensively with the concepts such as the basic elements of an auditor’s report, what is an unqualified opinion, the concept of modified audit report – qualified opinion, adverse opinion, disclaimer opinion, matters that affect the auditor’s opinion and matters that do not affect the auditor’s opinion, emphasis of matter paragraphs, illustrative audit reports in each case.

11.29 *AAS 29 : Auditing in a Computer Information Systems Environment*

A CIS environment exists when one or more computer(s) of any type or size is (are) involved in the processing of financial information, including quantitative data, of significance to the audit, whether those computers are operated by the entity or by a third party. The purpose of this

Auditing and Assurance Standard (AAS) is to establish standards on procedures to be followed when an audit is conducted in a computer information systems (CIS) environment. The AAS lays down standard in respect of skills and competence needed by the auditor to conduct an audit of CIS environment, factors to consider while planning such an audit, peculiar features of a CIS environment, assessment of risk, audit procedures to reduce audit risk, documentation in such audits.

11.30 *AAS 30 : External Confirmations*

This Auditing and Assurance Standard deals with an important form of audit evidence, viz., external confirmations. The Standard touches upon in details, with the various important aspects related to external confirmations. For example, relationship of external confirmation procedures to the inherent and control risks, assertions addressed by external confirmations, timing of external confirmations, design of the external confirmation request, nature of information being confirmed, form of confirmations – positive and negative, characteristics of respondents, evaluation of the results of the confirmation process, management requests etc.

11.31 *AAS 31 : Engagements to Compile Financial Information*

The salient feature of a compilation engagement is that in such types of engagements, the accountant uses accounting expertise as against auditing expertise to collect, classify and summarise financial information. Ordinarily, a compilation engagement involves reducing data to a manageable and understandable form and does not require the accountant to test the assertions underlying the concerned information. Moreover, the procedures adopted by the accountant in carrying out a compilation engagement do not enable him to express any assurance or opinion on that financial information.

The AAS deals extensively with significant issues such as the objective of a compilation engagement, basic principles in a compilation engagement, including the ethical requirements, responsibility of the management, the essential ingredients of the terms of a compilation engagement, planning, documentation and procedural aspects of a compilation engagement. The AAS also deals with the special considerations in case of clients having an identified financial reporting framework, clients having no financial reporting framework and situations of non compliance with the accounting standards by the client, estimates made by the client. The AAS also provides detailed guidance as to the reporting aspects in a compilation engagement. The AAS also contains an illustrative engagement letter for compilation engagements and also sample compilation reports covering different situations for the benefit of the members.

11.32 *AAS 32 : Engagements to Perform Agreed upon Procedures regarding Financial Information*

In an engagement to perform agreed upon procedures, the auditor is usually required to give a report on the factual findings, based on specified procedures performed on specified subject matters of specified elements, accounts or items of financial statements. The basic purpose of the AAS is to establish standards on the auditor's professional responsibilities when an engagement to perform agreed upon procedures regarding financial information is undertaken and on the form and content of the report that the auditor issues in connection with such an engagement. The AAS can, however, also be used as a guide to perform agreed upon procedures regarding non financial information. The AAS 32 thus, provides detailed guidance to the members as to the objectives of an agreed upon procedures engagement, basic principles involved in an agreed upon procedures engagement, including ethical principles, the essential aspects of the terms of the engagement. The AAS also deals with the planning, documentation and procedures and evidence aspects of such engagements. The AAS also

contains standards in respect of report to be issued by the auditor and its essential elements. The AAS also contains an illustrative engagement letter and an illustrative format of the report to be issued by the auditor.

11.33 *AAS 33 : Engagements to Review Financial Statements*

Unlike an audit, a review engagement is based mainly on analytical procedures and inquiries conducted by the auditor. The quarterly unaudited financial results of companies listed on stock exchanges in India are subject to limited review by the chartered accountants. The AAS on Engagements to Review Financial Statements provides extensive guidance on the types of such procedures and enquiries to be employed by the auditors. The AAS establishes standards and provide guidance on the auditor's professional responsibilities and on the form and content of the report that the auditor issues in connection with a review. The AAS deals with issues such as scope of the review engagement, level of assurance, terms of engagement, planning, documentation, review procedures, conclusions and reporting requirements in the review engagements. The AAS also illustrates format of engagement letter to be issued, review procedures to be applied and format of Review reports to be issued for qualified as well as unqualified opinion.

11.34 *AAS 34 : Audit Evidence – Additional Consideration for Specific Items*

The objective of this AAS is to establish standards on auditor's responsibilities, audit procedures and provide guidance, in addition to that provided in AAS-5, "Audit Evidence", with respect to certain specific financial statement amounts and other disclosures. This AAS assists the auditor to obtain audit evidence with respect to following aspects:

Part A: Attendance at Physical Inventory Counting.

Part B: Inquiry Regarding Litigation and claims.

Part C: Valuation and Disclosure of Long Term Investments.

Part D: Segment Information.

This AAS provides a detailed insight into each of these aspects. It provides guidance with respect to definition, procedures, management representations and audit conclusions and reporting for each of these parts.

11.35 *AAS 35 : The Examination of Prospective Financial Information*

The objective of this AAS is to provide guidance in respect of engagements to examine and report on prospective financial information. This AAS also covers specific aspects such as examination procedures for best estimates and hypothetical assumption.

This AAS also contains the illustrative formats of

- Unmodified Report on a Projection
- Unmodified Report on a Forecast

12. Method of accounting

- 12.1 If the institution is carrying on business it has to keep in mind the provisions of section 145. Under section 145 only cash method and mercantile method of accounting are permitted. However, where the institution does not have income either under the head “profits and gains of business or profession” or “income from other sources”, the provisions of section 145 will not apply.
- 12.2 As the form requires the examination of the balance sheet and the profit and loss account, it is necessary that these two statements should be drawn up in accordance with the generally accepted accounting principles including in particular, the time honoured distinction between capital and revenue. The balance sheet should, therefore, be a summary of assets and liabilities, and the profit and loss account should be a statement enumerating the various items of income and expenditure.
- 12.3 It is sometimes the practice with some trusts to charge certain capital expenditure also to the profit and loss account in terms of the requirements of certain authorities for the

sanction of grants. However, as the balance sheet has to be prepared on the basis of the generally accepted accounting principles, all assets must find a place in the balance sheet. In other words, even though capital expenditure may be charged off in the profit and loss account in order to satisfy the requirements of certain authorities for sanction of grants, for the purpose of preparing the income and expenditure account and the balance sheet on which the accountant has to give his report, it is necessary that a clear distinction between revenue and capital should be maintained and all the assets should be properly reflected in the balance sheet.

12.4 The forms of the balance sheet and the profit and loss account are not expressly prescribed. It is, therefore suggested that the balance sheet and the profit and loss account should be prepared in the generally accepted form. As Form No.10B also requires the auditor to comment on the truth and fairness of the financial statements, it is necessary to ensure that the extent of disclosure in the financial statements is fair and adequate. It is not possible to give precise guidance in this respect, as each case will depend on its own facts.

13. Form no.10B

Audit Report under section 12A(b) [now section 12A(1)(b)] of the Income-tax Act, 1961, in the case of charitable or religious trusts or institutions

*I/We have examined the balance sheet of (name of the trust or institution) as at and the profit and loss account for the year ended on that date which are in agreement with the books of account maintained by the said trust or institution.

*I/We have obtained all the information and explanations which to the best of *my/our knowledge and belief were necessary for the purposes of the audit. In *my/our opinion, proper books of account have been kept by

the head office and the branches of the above-named *trust/institution visited by *me/us so far as appears from *my/our examination of the books, and proper returns adequate for the purposes of audit have been received from branches not visited by *me/us, subject to the comments given below:

In *my/our opinion and to the best of *my/our information, and according to information given to *me/us, the said accounts give a true and fair view -

- (i) in the case of the balance sheet, of the state of affairs of the above-named *trust/institution as at, and
- (ii) in the case of the profit and loss account, of the profit or loss of its accounting year ending on

The prescribed particulars are annexed hereto.

Place

Date

Signed
†Accountant

Notes:

1. *Strike out whichever is not applicable.
2. †This report has to be given by -
 - (i) a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); and
 - (ii) any person who, in relation to any State, is, by virtue of the provisions of sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of the company registered in that State.
3. Where any of the matters stated in the report is answered in the negative, or with a qualification, the report shall state the reasons for the same.

14. Prescribed particulars in the Annexure

Annexure

I. Application of income for charitable or religious purposes

1. Amount of income of the previous year applied to charitable or religious purposes in India during that year
2. Whether the *trust/institution has exercised the option under clause (2) of the Explanation to section 11(1)? If so, the details of the amount of income deemed to have been applied to charitable or religious purposes in India during the previous year
3. Amount of income *accumulated or set apart/ finally set apart* for application to charitable or religious purposes, to the extent it does not exceed 25 per cent of the income derived from property held under trust *wholly/in part only* for such purposes. Note: Section 11 has been amended to provide for 15% instead of 25%.
4. Amount of income eligible for exemption under section 11(1)(c) (Give details)
5. Amount of income, in addition to the amount referred to in item 3 above, accumulated or set apart for specified purposes under section 11(2)
6. Whether the amount of income mentioned in item 5 above has been invested or deposited in the manner laid down in section 11(2) (b)? If so, the details thereof
7. Whether any part of the income in respect of which an option was exercised under clause

(2) of the Explanation to section 11(1) in any earlier year is deemed to be income of the previous year under section 11 (1B)? If so, the details thereof

8. Whether, during the previous year, any part of income accumulated or set apart for specified purposes under section 11(2) in any earlier year-

(a) has been applied for purposes other than charitable or religious purposes or has ceased to be accumulated or set apart for application thereto, or

(b) has ceased to remain invested in any security referred to in section 11(2)(b)(i) or deposited in any account referred to in section 11(2)(b)(ii) or section 11(2)(b)(iii), or

(c) has not been utilised for purposes for which it was accumulated or set apart during the period for which it was to be accumulated or set apart, or in the year immediately following the expiry thereof?

If so, details thereof

II. Application or use of income or property for the benefit of persons referred to in section 13(3)

1. Whether any part of the income or property of the trust/institution was lent, or continues to be lent, in the previous year to any person referred to in section 13(3) (hereinafter referred to in this Annexure as such person)?
If so, give details of the amount, rate of interest charged and the nature of security, if any

2. Whether any land, building or other property of the *trust/institution was made, or continued to be made, available for the use of any such person during the previous year? If so, give details of the property and the amount of rent or compensation charged, if any
3. Whether any payment was made to any such person during the previous year by way of salary, allowance or otherwise? If so, give details
4. Whether the services of the *trust/ institution were made available to any such person during the previous year? If so, give details thereof together with remuneration or compensation received, if any
5. Whether any share, security or other property was purchased by or on behalf of the trust/institution during the previous year from any such person? If so, give details thereof together with the consideration paid
6. Whether any share, security or other property was sold by or on behalf of the *trust/institution during the previous year to any such person? If so, give details thereof together with the consideration received
7. Whether any income or property of the *trust/institution was diverted during the previous year in favour of any such person? If so, give details thereof together with the amount of income or value of property so diverted
8. Whether the income or property of the *trust/ institution was used or applied during the previous year for the benefit of any such person in any other manner?

If so, give details

* Strike out whichever is not applicable.

III. Investments held at any time during the previous year(s) in concerns in which persons referred to in section 13(3) have a substantial interest

S. No.	Name and address of the concern	Where the concern is a company, number and class of shares held	Nominal value of the investment	Income from the investment	Whether the amount in col.4 exceeds 5 per cent of the capital of the concern during the previous year-say, Yes/No
1	2	3	4	5	6
Total					

Place.....

Date.....

.....

Signed

Accountant

15. Audit report under section 12A(1)(b)

- 15.1 The audit report consists of four paragraphs. The first paragraph contains the declaration about the examination of the balance sheet and the profit and loss account and also

whether they are in agreement with the books of account maintained by the institution. The second paragraph requires the accountant to state whether he has obtained all the information and explanations necessary for the purposes of audit. It also requires a statement by the accountant regarding the maintenance of proper books of account by the head office and branches. The accountant has also to state whether he has received from branches proper returns adequate for the purpose of audit. The third paragraph requires the accountant to state whether in his opinion the accounts give a true and fair view, in the case of the balance sheet, of the state of affairs of the institution on the relevant date and in the case of the profit and loss account, of the profit or loss of its accounting year ending on the relevant date. The last paragraph requires the accountant to state that the prescribed particulars are annexed to the audit report.

- 15.2 AAS 28 – The Auditor’s Report on Financial Statements states that the auditor’s report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the auditor’s report is addressed to the authority appointing the auditor. In the present case the assessee has to furnish the audit report along with the return of income. The accountant has to address the audit report to the assessee.

16. Examination of balance sheet and the profit and loss account

I /We have examined the balance sheet of (name of the trust or institution) as at and the profit and loss account for the year ended on that date which are in agreement with the books of account maintained by the said trust or institution.

- 16.1 The accountant should ensure agreement between the books of account and the financial statements. Since the balance sheet and the profit and loss account have to exhibit a true and fair view, it, therefore, follows that the books of account, which should agree with the balance sheet and the profit and loss account, must themselves be written up in a manner which would lead to the extraction of the financial statements showing a true and fair view. The requirement as to maintenance of proper books of account, which is dealt with subsequently, should, therefore, be linked with this requirement.

17. Information and explanations

I/We have obtained all the information and explanations which to the best of my/our knowledge and belief were necessary for the purposes of the audit. In my/our opinion, proper books of account have been kept by the head office and the branches of the above-named trust/institution visited by me/us so far as appears from my/our examination of the books, and proper returns adequate for the purposes of audit have been received from branches not visited by me/us, subject to the comments given below:

- 17.1 The audit report has to state that all information and explanations which, to the best of the accountant's knowledge and belief, were necessary for the purpose of audit have been obtained. This requirement is identical to the requirement in respect of the auditor's report under the Companies Act where a similar averment is required to be made in the audit report. The accountant should maintain proper documentation and working papers to demonstrate that the information and explanations obtained by him from

the institution are adequate having regard to the requirements of the Act.

- 17.2 The form requires the accountant to report that proper books of account have been maintained and proper returns have been received from branches not visited by the accountant. It needs to be noted that neither the Act nor the Rules specify the nature of books of account to be maintained or the procedure concerning branch returns. Therefore, the word "proper", both in relation to the books of account and in relation to the returns from branches, has to be interpreted in the context as meaning the books of account and returns which are adequate for the purpose of the accountant's report including therein statements as to the truth and fairness of the financial statements. Therefore, by implication, the books of account have to be written up indicating the various items of income and expenditure and assets and liabilities, so that they can lead to the preparation of the financial statements showing a true and fair view. The same requirement would also relate to the branch returns, although it would appear that if the accountant expresses an opinion on the financial statements as a whole, he must subject the branch returns to such checks and scrutiny as may be deemed necessary by him to enable him to express such an opinion. In cases where the provisions of section 44AA are applicable, the word "proper" would also imply that the books of account conform to the requirements of section 44AA and the rules framed thereunder.
- 17.3 The expression "subject to the comments given below:" used in the sentence dealing with the accountant's report on the maintenance of proper books of account and proper branch returns indicates the qualifications which the accountant should specify immediately below the paragraph. A plain reading of the above requirement indicates that the comments of the accountant are required to be given just above the paragraph commencing with "In *my/our opinion....." However, a reference to foot-note 3 in the prescribed form would indicate that the accountant's negative

report or qualifying report can relate to any part of the report. In other words, while the form of audit report is prescribed, it is not possible to adhere to it absolutely in the same form in which it is given. Under appropriate circumstances the accountant has to indicate the qualifications suitably. The accountant should comply with the requirements of the AAS 28 – The Auditor’s Report on Financial Statements.

18. Opinion about the true and fair view

In my/our opinion and to the best of my/our information, and according to information given to me/us, the said accounts give a true and fair view -

- (i) in the case of the balance sheet, of the state of affairs of the above-named trust/institution as at, and***
- (ii) in the case of the profit and loss account, of the profit or loss of its accounting year ending on***

- 18.1 The prescribed form requires the auditor to report on the truth and fairness of the financial statements. While the auditors are familiar with the concept of truth and fairness they have to keep in mind the less organised state of affairs in the administration of institutions. The accounting systems as prevailing in trusts may widely differ; donations in kind may be received defying precise quantitative and monetary values; the commitments both as to donations or grants already offered, may be of doubtful or imprecise knowledge. In such circumstances, the accountant, apart from applying his usual checks and scrutiny, will have to rely on the management representations obtained from the competent authority managing the institutions as to the completeness of the entries in the books of account in respect of assets, liabilities, income and expenditure, valuation of various assets and accounting in respect of various liabilities both

actual and contingent etc. As this report is an expression of opinion about the truth and fairness of general purpose financial statement, the accountant is advised to follow all the AASs in conducting the audit.

19. Particulars

The prescribed particulars are annexed hereto.

Although there is no specific requirement for the accountant to certify the correctness of the particulars in the annexure, he has to affix his signature at the end of the particulars, implying thereby that the accountant is taking the responsibility for verifying the correctness of the particulars given by him in the annexure.

20. Annexure to the audit report

- 20.1 The annexure to the audit report contains a statement of particulars to be given under three parts. Under part I the details regarding application of income for charitable or religious purposes, under part II the details of application or use of income or property for the benefit of persons referred to in section 13(3) and in part III investments held at any time during the previous year(s) in concerns in which persons referred to in section 13(3) have a substantial interest have to be given.
- 20.2 The various particulars in the annexure to Form No.10B would be filled up after completion of audit, finalisation and certification of income and expenditure account and balance sheet. The audited financial statements would form the primary document from which the answers to the various questions asked for in the annexure shall be given.
- 20.3 The auditor may verify the following basic documents in order to enable him to give the various particulars required in the annexure.
- (a) income and expenditure account,
 - (b) balance sheet,

- (c) receipts and payments account,
- (d) minutes book of the governing body,
- (e) past income-tax records,
- (f) income-tax statement computed for the current year,
- (f) profit and loss account for the business and income-tax computation statement for that business,
- (g) copy of the trust deed/bye-laws/memorandum of articles, as the case may be.

21. I. Amount of income applied during the previous year

This part requires the accountant to set out eight different particulars relating to various aspects such as application of income, accumulation of income, exercise of option for accumulation and investment of accumulated income etc.

22. Income applied

“1. Amount of income of the previous year applied to charitable or religious purposes in India during that year”

- 22.1 The scope of the word “income” has to be understood in the context of section 11. The words “income” and “total income” have altogether different connotations in the Act. The expression “income” here has to be understood in the commercial sense and not in the sense in which the income is arrived at for purposes of assessment to tax. In other words, from the total receipts the expenses necessary for earning that income have to be deducted. The net amount that remains would be available for distribution or application for charitable purposes. In applying the income for charitable purposes, even capital expenditure may be incurred. The Central Board of Direct Taxes has also taken the same view in its circular No. 5-P LXX-6 of 1968 dated 19th June, 1968. The relevant circulars in this regard are given in ***Annexure - V***.

- 22.2 “Applied” in this context means that the income is actually applied for the charitable or religious purposes of the trust [*H.E.H. Nizams Religious Endowment Trust v. CIT (1966) 59 ITR 582, 588 (SC)*]. The word “applied” need not necessarily imply that the amount should be actually spent. Even if an amount is irretrievably earmarked and allocated for the charitable or religious purpose(s), it would amount to application. [*CIR v. Radhaswami Satsang Sabha (1954) 25 ITR 472, 522-3 (All)*]; *CIT v. H.E.H. The Nizams Charitable Trust (1981) 131 ITR 497, 501- 02 (AP)*]. A mere credit entry in the books of the trust in the expectation of future income is not sufficient [*Nachimuthu Industrial Association v CIT (1980) 123 ITR 611 (Mad)*] but a credit entry made to allocate already earned income followed by some payments made in the year was held proper application [*CIT v Thanthi Trust (1982) 137 ITR 735 (Mad)*].
- 22.3 An important issue for consideration is, for the purpose of determining the income available for application for charitable purposes, should the gross income be taken or the net income after deducting all expenses incurred to earn the income. In this connection the following extracts from the judgement of the Hon’ble Supreme Court in *CIT v. Programme for Community Organisation [2001] 248 ITR 1* are significant to note:

“The question that really requires consideration is whether, for the purposes of section 11(1)(a) of the Income-tax Act, 1961, the amount for the grant of exemption of twenty-five per cent, should be the income of the trust or it should be its total income as determined for the purposes of assessment to income-tax. This question has to be answered in the light of these facts: The assessee-trust received donations in the aggregate sum of Rs.2,57,376. It applied thereout for its charitable purposes the aggregate sum of Rs.1,70,366 leaving a balance of Rs.87,010. The question is whether the assessee is entitled to accumulate twenty-five per cent of

Rs.2,57,376 as it contends, or twenty-five per cent of Rs.87,010 as the Revenue appeared to contend.

.....

Having regard to the plain language of the above provision, it is clear that a charitable or religious trust is entitled to accumulate twenty-five (now 15%) per cent of its income derived from property held under trust. For the present purposes, the donations the assessee received, in the sum of Rs.2,57,376, would constitute its property and it is entitled to accumulate twenty-five per cent. thereout. It is unclear on what basis the Revenue contended that it was entitled to accumulate only twenty five per cent of Rs.87,010.”

Agricultural Income: However, the agricultural income will not form of total income for purpose of computing accumulation of income in excess of 25% (now 15%) of total income as laid down under section 11, *CIT v Nabhinandan Digambar Jain (2002) 257 ITR 91 (MP)*.

In case where the trust is carrying on any business in furtherance and incidental to its main objects a question may arise whether the gross receipts and the gross expenses will be treated as the income and application for this section. It has been held in *CIT v. Birla Janhit Trust 208 ITR 372 (Cal.)* that expenditure on salary and miscellaneous expenditure for carrying out purposes of trust must be considered as application for charitable purposes. Similarly, In *CIT v Programme for Community Organisation 228 ITR 620 (Ker.)* it has been held that for the purpose of computation of accumulation of income, the income should be as disclosed in the accounts and not as computed under section 2(45) of the Income-tax Act which defined ‘total income;’.

- 22.4 The expression ‘application to charitable purposes’ is one of wide import. To find out whether the ‘income’ of a charitable trust has been applied for charitable purposes, the auditor should have due regard to the objects of the trust and

various judicial decisions in this regard. The following illustrative cases have been given to understand the scope of the expression.

(a) Application need not be only for revenue expenditure

Further, in order to get the benefit of exemption from tax under section 11 of the Act, it is not necessary that the application of the income should be such as to result in revenue expenditure. Where the dominant object of the trust was to establish a "Dharamshala" for the use of the Hindu public, the Gujarat High Court held in *Satya Vijay Patel Hindu Dharamshala Trust v. CIT (1972) 86 ITR 683* that the amounts spent by the trustee in the construction of the new Dharamshala was an application of income towards the charitable purposes of the trust.

(b) Depreciation on capital expenditure

Even when the whole of the capital expenditure may be treated as an application of income towards charitable or religious purposes for the purposes of section 11, the trust may also claim depreciation in respect of the assets used by it for its purposes on the basis of normal commercial principles following the Circular No. 5-P (LXX-6) of 1968 dated 19th June, 1968 issued by the CBDT. Also see **Annexure V**.

(c) Repayment of loan

The CBDT by its Circular No.100 dated 24th January, 1973 (F.No.195/1/72-IT (A.1.)) vide **Annexure-V** also observed that repayment of loan originally taken by a trust to fulfill one of its objects will amount to an application of income for charitable and religious purposes within the meaning of the Act. It also observed in that circular that where the object of the trust is advancement of education and it grants scholarship loans to students for higher studies in fulfillment of the objectives of the trust, granting of such loans, even if interest-bearing, will amount to application of income for charitable purposes. However, when the loan is returned to the trust, it will be

treated as the income of that year. It was held in *CIT vs Janambhumi Press Trust (2000) 242 ITR 457(Kar)* that where the assessee trust constructed a building out of its accumulated income as well as from borrowed funds, and later earned rental income from the said building, a part of which was utilized for the repayment of the borrowed funds, such repayment of debt was treated to be as application of income for purpose of section 11.

(d) *Payment of taxes*

Expenditure by way of payment of tax out of current year's income has to be considered as application for charitable purposes because the payment has been made to preserve the corpus, the existence whereof is essential for the trust itself. [*CIT v. Janaki Ammal Ayya Nadar Trust (1985) 153 ITR 159 (Mad)*].

- 22.5 In respect of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution, the conditions regarding application of income to such receipts will not apply.
- 22.6 The accountant is required to :
- (a) verify the income as defined under section 11 and 12 of the Income-tax Act. Basically income can be classified into five broad categories viz.,
 - (i) voluntary contributions made with a specific direction that they shall form part of corpus;
 - (ii) voluntary contributions made without a specific direction that they shall form part of corpus;
 - (iii) profits and gains of business which are incidental for attaining the objects;
 - (iv) other general receipts;
 - (v) capital gains;
 - (b) verify the amount actually applied during that year by culling out the figures from
 - (i) income and expenditure account;

- (ii) balance sheet and/or receipts and payments account.
- (c) verify the donations made to another trust in terms of section 11(3)(d).
- (d) verify the valuation of services made available to specified category of persons in terms of section 12(2).
- (e) verify the anonymous donations. In this connection the particulars are yet to be prescribed by the Government. Hence, it would be advisable for the accountant to get appropriate management representation.

23. Income deemed to have been applied

2. *Whether the *trust/institution has exercised the option under clause (2) of the Explanation to section 11(1)? If so, the details of the amount of income deemed to have been applied to charitable or religious purposes in India during the previous year*

- 23.1 Sometimes the income applied to charitable or religious purposes during the previous year may fall short of 75 per cent of the income derived during the year. This may be due to the fact that the income has not been received during the previous year or for any other reason. The institution can still get the exemption in respect of such short fall provided it satisfies the conditions regarding exercise of option. The procedure for exercising the said option is given in clause (2) of Explanation under section 11(1).
- 23.2 For example, suppose a trust derives an income of Rs.10 lakhs during the previous year ended 31st March, 2001. It has actually spent a sum of Rs.5 lakhs only. It could not spend :-

- (a) Rs.1.50 lakhs for the reason that the income of Rs.1.50 lakhs has not been received.
- (b) Rs.1.00 lakh for some other reason (say either the amount has been received late or the beneficiary could not be immediately found).

Now the trust can exercise the option under clause (2) of the Explanation to section 11(1) for the unspent amount of Rs.2.50 lakhs for the previous year 2000-01 (A.Y. 2001-02).

In the case of (a) above, if the amount of Rs.1.50 lakhs is received in the previous year ended 31.3.2002, the trust has to apply it for charitable purposes either during the previous year 2001-02 or during 2002-03. If not applied, the unapplied portion is taxable in the previous year 2002-03 (A.Y. 2003-04).

In the case of (b) above, the trust has to apply the amount of Rs.1 lakh during the previous year 2001-02. If not applied, the unapplied portion is taxable in the previous year 2001-02 (A.Y. 2002-03). This taxability aspect is to be reported in point No.7 para 28.

- 23.3 For the purpose of getting the benefit of deemed application of income the person in receipt of the income should exercise an option in writing before the expiry of the time allowed under section 139(1) for furnishing the return of income. Once the option is exercised, such income will be deemed to be income applied to charitable purposes during the previous year in which the income was derived.
- 23.4 The accountant should indicate against item no.2 yes or no as an answer to the question asked in the first segment. For the second segment of the question he has to give the amount of income in respect of which option has been exercised by the person in receipt of the income.

23.5 The accountant may

- (a) check from the income-tax computation statement whether there is any short fall in the application of income;
- (b) check whether the short fall is for the reasons stated in clause (2) of the Explanation to section 11(1) viz.,
 - (i) amount not received,
 - (ii) any other reason;
- (c) check whether a resolution has been passed by the governing body for exercising the option under the section referred above;
- (d) check whether the letter exercising the option has been filed with the Assessing Officer before the time allowed under section 139(1) for filing return of income;
- (e) obtain a copy of that letter and the proof for date of filing the same;
- (f) report the amount for which the option has been exercised under this column and
- (g) examine specifically any special exemption like allowing the expenditure to be done subsequently, e.g. earthquake relief in Gujarat State etc.

24. Income set apart for application

- 3. *Amount of income accumulated or set apart finally set apart for application to charitable or religious purposes, to the extent it does not exceed 25 per cent of the income derived from property held under trust wholly/ in part only for such purposes***

- 24.1 An institution is permitted to accumulate income to the extent of 15 per cent of its income (earlier 25%).
- 24.2 The amount of income accumulated is to be mentioned here if the amount does not exceed 15% (earlier 25%). If it exceeds 15% (earlier 25%) the excess amount should be specifically indicated.
- 24.3 The amount of income derived and the amount actually applied would have been determined while answering question no.1 supra. If the shortfall is less than 15% (earlier 25%) of the gross income, then the amount set apart for general accumulation would normally be the same amount. If the shortfall is more than 15% (earlier 25%) of the gross income, then the amount set apart for general accumulation shall not exceed 15% (earlier 25%) of the gross income.
- 24.4 The accountant may obtain a certificate from the governing body of the institution regarding the amount set apart for general accumulation and report under this clause and he may verify the exclusion of the amount received directly to the corpus of the trust fund for the purposes of this clause.

25. Exemption under section 11(1)(c)

4. Amount of income eligible for exemption under section 11(1)(c) (Give details).

- 25.1 Under section 11(1)(c), income derived from property held under trust - (i) created on or after the 1st day of April, 1952, for charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and (ii) for charitable or religious purposes created before the 1st day of April, 1952, to the extent to which such income is applied to such purposes outside India will be exempt. The amount so spent has to be indicated against this item.

- 25.2 The amount would be exempt if there is a Board's order and
- (i) if the trust is created before the first day of April, 1952, income may be applied for charitable or religious purposes, as the case may be, outside India.
 - (ii) if the trust is created on or after the day of April 1952, income should be applied outside India for such purpose which tends to promote international welfare in which India is interested. The amount so spent should be reported under this clause.
- 25.3 The accountant may
- (a) obtain a copy of Board's order exempting the relevant income;
 - (b) ascertain the date of creation of the institution;
 - (c) ascertain the purpose for which the amount has been applied and
 - (d) examine specifically whether there are special exemptions by Board's Order of certain incomes which are not forming part of the income.

26. Income accumulated in excess of the specified limit

5. *Amount of income, in addition to the amount referred to in item 3 above, accumulated or set apart for specified purposes under section 11(2).*

- 26.1 Section 11(2) provides that where eighty five per cent of the income referred to in clause (a) or clause (b) of sub-section (1) read with Explanation to that sub-section is not applied, or is not deemed to have been applied, to charitable or 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 the

income provided the following conditions are complied with namely:-

- (a) such person specifies, by notice in writing given to the Assessing Officer in the prescribed manner, the purpose for which the income is being accumulated or set apart and the period for which the income is to be accumulated or set apart, which shall in no case exceed five years;
- (b) the money so accumulated or set apart is invested or deposited in the forms or modes specified in sub-section (5).

26.2 Thus even out of the mandatory ceiling limit of eighty five per cent of income to be applied, an institution can accumulate or set apart a portion for specified purposes under section 11(2). The accountant has to indicate the amount so accumulated against item No.5.

26.3 The accountant is advised to

- (a) check whether a resolution has been passed by the Governing Body for accumulation of income for a specific purpose;
- (b) obtain a copy of resolution;
- (c) obtain a copy of notice in Form No.10 if filed before completion of audit and note the amount accumulated. The amount so specified shall be reported under this clause and
- (d) where Form No.10 has not been filed the accountant has to check the amount accumulated from a copy of the resolution passed by the governing body.

It has been held in *Mermanjeet Trust v. CIT 148 ITR 214 (P & H)* and *Trustees of Tulsidas Gopalji Charitable Trust v. CIT 207 ITR 368 (Bom)* that if Form No.10 is filed after time limit prescribed by section 139(1) but before completion of assessment, the assessee will be entitled for exemption. Similar inference may also be drawn from the judgement of

Apex Court in *CIT v. Nagpur Hotel Owners Association* 247 ITR 201 (SC).

26.4 Sections 11(2)(a) and (b) prescribe the conditions to be observed for successful accumulation in excess of 15 per cent of the trust income. One of the conditions is that such excess percentage is to be kept invested in specified securities and/or deposits. The “manner” has been ‘prescribed’ in rule 17 which refers to Form No.10 as the form of notice. The time limit for filing Form No. 10 is the same time limit as for filing the return of income under section 139(1). This time limit is prescribed in Rule 17. Paragraph 2 of Form No.10 says that the relevant investments are to be made before the expiry of six months from the end of the previous year In *M. CT. Muthia Chettair Family Trust v. ITO* [1972] 86 ITR 282 (Mad), affirmed, *ITO v. M.C.T. Trust*, (1976) 102 ITR 138 (Mad)], and *CIT v. Shree Padmanabhaswami Temple Trust* [(1979) 120 ITR 42 (Ker)], it was held that the words “in the prescribed manner” in section 11(2)(a) do not confer power on the rule-making authority to prescribe a time-limit. That portion of Form No.10 has been declared ultra vires [Also see, *S.T.O. v. K.I. Abraham*, (1967), 20 STC 367 (SC); *Solar Works v. E.S.I. Corporation* (1964) 2 MLJ 223 (Mad); *CIT v. Shri Krishen Chand Charitable Trust*, (1975) 98 ITR 387 (J&K); *CIT v. S.R.M.C.T.M. Tiruppani Trust* (1984) 150 ITR 642 (Mad)]. This is so because a form cannot quantify a statutory provision or impose a time-limit which the statute does not provide [CIT v. Trustees of *Shri Teckchand Chandiram Trust*, (1990) 184 ITR 537, 540 (Bom)].

26.5 In this connection attention is invited to paragraph 42.7 of the Guidance Note on Tax Audit under section 44AB of the Income-tax Act, which is as follows:

“Under the first proviso to section 43B, deduction is available in respect of any sum referred to in clause (a), (c), (d) or (e) which is actually paid by the assessee on or before the due date applicable in his case for furnishing the return of income

under sub-section (1) of section 139. Since the due date of filing of the return would usually be subsequent to the signing of the tax audit report the tax auditor would be able to give information in respect of matters only upto the date of signing of the tax audit report. This fact should be stated under this clause by way of note as follows:

NOTE: Information given under clause 21(i) (B) is only up to and does not include any payment which the assessee may make subsequently before the due date of filing of the return of income under section 139(1).

The payment made subsequent to that date but before the date of filing of the return, will still be eligible for deduction under section 43B. Hence the tax auditor should advise the assessee to include necessary evidence of payments made after the signing of the tax audit report but before the due date of filing. This evidence may also be in the form of a certificate from a chartered accountant obtained specifically for this purpose - Circular No.601 dated 4.6.1991 vide Appendix XVII.”

26.6 The above quoted guidance given in relation to payments coming within the scope of section 43B has to be appropriately applied by the accountant in relation to the information to be given in Form No. 10.

27. Investment or deposit in the prescribed manner

6. Whether the amount of income mentioned in item 5 above has been invested or deposited in the manner laid down in section 11(2) (b)? If so, the details thereof

27.1 As noted in paragraph 23.1 an institution can exercise an option under section 11(2) to accumulate specified incomes. Section 11(2)(b) requires the money accumulated or set apart as mentioned in item five above to be invested or

deposited in the forms or modes specified in sub-section (5) of section 11.

27.2 The accountant has to state against item no.6 whether the amount of income mentioned in item no.5 has been invested or deposited in the prescribed manner. The institution might have complied with this requirement fully or partially. The institution should be requested to prepare a classified chart of its investments/deposits in accordance with the statutory requirements. Depending upon the extent to which compliance has been made by the institution in this regard the accountant has to give the necessary details. Those investments/ deposits which do not comply with the statutory requirements should be segregated and shown separately. Further, it is significant to note that the trustee/principal officer of the institution should undertake that before the expiry of six months commencing from the end of each previous year, the amount so accumulated or set apart has been/will be invested or deposited in any one or more of the forms or modes specified in sub-section (5) of section 11. This requirement is mentioned in Form No.10.

27.3 The accountant may

- (a) check whether the amount has been invested within six months from the end of the previous year;
- (b) obtain the details of investments made from the books of account and investment register;
- (c) check whether the investment or deposit made are only in the forms and modes specified in section 11(5);
- (d) wherever he considers necessary, physically verify the investments made by the institution as per section 11(5) and
- (e) report the details of investments.

28. Deemed income under section 11(1B)**7. Whether any part of the income in respect of which an option was exercised under clause (2) of the Explanation to section 11(1) in any earlier year is deemed to be income of the previous year under section 11 (1B)? If so, the details thereof.**

28.1 Section 11(1B) provides that where any income in respect of which an option is exercised under clause (2) of the Explanation to sub-section (i) is not applied to charitable or religious purposes in India during the period referred to sub-clause (a) or, as the case may be, sub-clause (b), of the said clause then such income shall be deemed to be the income of the person as provided therein.

28.2 The accountant may

- (a) check whether any option under the relevant section had been exercised in any of the earlier years and also obtain management representation to this effect;
- (b) analyse whether the option, if exercised, is towards
 - (i) non-receipt of income or
 - (ii) any other reason;
- (c) if the option is for non-receipt of income, check the year of receipt. For the current year, he should check whether the same had been received in the immediately preceding year and the amount, if any, applied for charitable purpose;
- (d) if the option is for any other reason, check whether the same has been applied in the current year since the option should have been exercised in the immediately preceding previous year only and
- (e) give the details of such deemed income clearly stating the particular year to which such deemed

income relates. Reference is also invited to paragraph no. 23.2.

29. Application for non-charitable purposes

8. Whether, during the previous year, any part of income accumulated or set apart for specified purposes under section 11(2) in any earlier year-

- (a) has been applied for purposes other than charitable or religious purposes or has ceased to be accumulated or set apart for application thereto, or**
- (b) has ceased to remain invested in any security referred to in section 11(2)(b)(i) or deposited in any account referred to in section 11(2)(b)(ii) or section 11(2)(b)(iii), or**
- (c) has not been utilised for purposes for which it was accumulated or set apart during the period for which it was to be accumulated or set apart, or in the year immediately following the expiry thereof?**

If so, details thereof

Note: In clause (b), reference to section 11(2)(b)(i), 11(2)(b)(ii) and 11(2)(b)(iii) appears to be a mistake and it appears reference be made to sections 11(5)(i), 11(5)(ii) and 11(5)(iii) respectively.

29.1 Where any part of the income accumulated or set apart for specified purposes under section 11(2) in any earlier year has not been applied for charitable purposes or has ceased to remain invested in specified securities or has not been utilised for purposes for which it was accumulated, then it will

be treated as income in the year in which such non-compliance occurs.

- 29.2 The accountant should scrutinise the financial statements and audit reports of earlier years for ascertaining accumulations made by the trust or institution in earlier years, application of income in the current year out of the accumulations of earlier year(s).
- 29.3 Many a time the accountant may not be in a position to get all the particulars required by the above clause. Hence, he can obtain a management representation and thereafter verify the particulars as given by the management and give the same under this clause.
- 29.4 The accountant may
- (a) check the amount spent out of accumulated income of the relevant earlier year and whether it was spent for the same object for which it was accumulated or not. If not, he should specifically mention the deviation or should mention whether the application/ permission for change of object clause was made/obtained or not;
 - (b) if the amount accumulated has ceased to be so accumulated or was not spent for the object for which it was accumulated, verify the necessary resolution and should account for such income accordingly;
 - (c) check whether the accumulated amount has ceased to remain invested as per section 11(5) and if any deviation is noted, report the same;
 - (d) verify the investments at the end of every year;
 - (e) examine the accounting treatment and taxability of the accumulated surplus if the same has not been spent or period of accumulation has expired;
 - (f) ascertain the present position of each such accumulation and investment to verify the following:
 - (i) whether the accumulated amount has been utilised for purposes other than charitable or religious purposes;

- (ii) whether it has ceased to be accumulated or set apart for accumulation thereto;
 - (iii) whether the corresponding investment is in tact or has ceased to remain invested in any approved form;
 - (iv) whether the period for which it was accumulated has expired or not. If it has expired whether the accumulated portion has been used for the purpose for which it was accumulated within that period or in the year immediately following the expiry thereof and
- (g) prepare a detailed chart as given in Schedule I of revised return Form No.3A in order to have effective control over such accumulations and investments. (The schedule I is given below.)

SCHEDULE - I

DETAILS OF AMOUNTS ACCUMULATED/ SET APART WITHIN THE MEANING OF SECTION 11(2) IN THE LAST ELEVEN YEARS VIZ., PREVIOUS YEAR RELEVANT TO THE CURRENT ASSESSMENT YEAR AND THE TEN PRECEDING ASSESSMENT YEARS :-

Year of accumulation	Amount accumulated	Whether invested in accordance with the provisions of Section 11(5)	Purpose of accumulation	Amounts applied during the year	Balance amount available for application	Amount deemed to be income within meaning of sub-section 3 of section 11

30. II - Application or use of income or property for the benefit of persons referred to in section 13(3)

- 30.1 This part requires details of application or use of income or property for the benefit of persons referred to in section 13(3). These details are necessary because under section 13(1)(c), exemption is not available under section 11 or 12 in respect of any part of income or any property of the institution used or applied directly or indirectly for the benefit of any person referred to in sub-section (3) of section 13. As per proviso to section 13(2)(g) any application of income or property upto Rs.1000/- in favour of the specified persons would not disentitle the institution from exemption.
- 30.2 The details required to be furnished by the accountant as mentioned from items 1 to 8 of Part II of the Annexure as mentioned in paragraphs 31 to 38 are in respect of transactions amounting to utilisation of the income or properties of the institution for the benefit of a specified category of persons. The accountant should obtain management representation in respect of persons referred to in section 13(3) on which he can rely. The CBDT has accepted this view vide Circular No.143 [L.F.No.180/74/73-IT(A1)] dated 20.8.1974 vide **Annexure - V**.

31. Lending of income or property

- 1. *Whether any part of the income or property of the trust/institution was lent, or continues to be lent, in the previous year to any person referred to in section 13(3) (hereinafter referred to in this Annexure as such person)? If so, give details of the amount, rate of interest charged and the nature of security, if any***

- 31.1 The accountant may
- (a) analyse the receivables and find out whether it includes the names of any such persons;

- (b) ascertain whether the given amount is a loan/deposit and
- (c) if it is a loan/deposit, verify the documents, securities offered and rate of interest.

32. Use of land, building or other property

2. *Whether any land, building or other property of the *trust/institution was made, or continued to be made, available for the use of any such person during the previous year? If so, give details of the property and the amount of rent or compensation charged, if any*

32.1 The accountant may

- (a) check the list of assets owned by the institution;
- (b) ascertain whether the assets have been made available for the use of specified persons and
- (c) report the details of rent or compensation charged.

33. Payment of salary, allowance etc.

3. *Whether any payment was made to any such person during the previous year by way of salary, allowance or otherwise? If so, give details*

33.1 The accountant may get a management representation in respect of any payment by way of salary, allowance or payments of a similar nature and verify such details and report the same under this clause.

34. Services made available

4. *Whether the services of the *trust/ institution were made available to any such person during the previous year? If so, give details thereof together with remuneration or compensation received, if any*

34.1 The accountant may get a management representation in respect of any services made available to specified persons and verify such details and report the same under this clause.

35. Purchase of shares, security or other property

5. *Whether any share, security or other property was purchased by or on behalf of the trust/institution during the previous year from any such person? If so, give details thereof together with the consideration paid*

35.1 The accountant may get a management representation in respect of any purchase of shares, security or other property from the specified persons and verify such details and report the same under this clause.

36. Sale of share, security or other property

6. *Whether any share, security or other property was sold by or on behalf of the *trust/institution during the previous year to any such person? If so, give details thereof together with the consideration received*

36.1 The accountant may get a management representation in respect of any sale of shares, security or other property to any specified persons and verify such details and report the same under this clause.

37. Diversion of any income or property

7. *Whether any income or property of the *trust/institution was diverted during the previous year in favour of any such person? If so, give details thereof together with the amount of income or value of property so diverted*

37.1 A decline in income of the institution as compared to the previous year may indicate the need to further examine the relevant documents to ascertain whether any diversion of income or property has taken place.

37.2 The accountant should get a management representation in respect of any such diversion of income or property and verify such details and report the same under this clause.

38. Application of income or property in any other manner

8. *Whether the income or property of the *trust/institution was used or applied during the previous year for the benefit of any such person in any other manner?*

If so, give details

*** Strike out whichever is not applicable.**

38.1 The accountant should get a management representation in respect of application of any income or property for the benefit of specified persons in any other manner and verify such details and report the same under this clause.

39. Medical or educational services

39.1 The accountant should get a management representation in respect of any medical or educational services made available to the prohibited

category of persons in terms of section 12(2) and report the same under this clause.

40. III. Investments held at any time during the previous year(s) in concerns in which persons referred to in section 13(3) have a substantial interest

S. No.	Name and address of the concern	Where the concern is a company, number and class of shares held	Nominal value of the investment	Income from the investment	Whether the amount in col. 4 exceeds 5 per cent of the capital of the concern during the previous year-say, Yes/No
1	2	3	4	5	6
Total					

Place.....

Date.....

.....

Signed

Accountant

40.1 Sub-section (3) of section 13 gives details of persons for whose benefit the income or property of the institution should not be used. They are as follows:

(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, that is to say, any person whose total contribution at the end of the relevant previous year exceeds fifty thousand rupees;
- (c) where such author, founder or person is a Hindu undivided family or a member of the family;
- (d) any trustee of the trust or manager (by whatever name called) of the institution;
- (e) any relative of any author, founder, person, member, trustee or manager as aforesaid;
- (f) any concern in which any of the persons referred to in clauses (a), (b), (c) (d) and (e) has a substantial interest.

The funds of the institution should not be invested in a concern mentioned in (f) above. Part III of the annexure requires details of investments held by the institution in such concerns during the previous year.

40.2 The accountant may

- (a) obtain a list of concerns in which the persons referred to in section 13(3) have got substantial interest;
- (b) verify the investments of the institution and ascertain whether any investments have been made in the concerns referred to in (a) above;
- (c) verify the nominal value of investments;
- (d) verify the details of income from such investments and
- (e) get a certificate for the amount of capital of the concern and calculate the percentage of the institution's investment in that concern.

41. Furnishing of audit report

41.1 To avoid any unnecessary difficulty, it is advisable that the audit report should accompany the return itself. A charitable

trust is entitled to claim exemption from income-tax, even if the audit report is submitted before completion of assessment or in course of appellate proceedings as laid down in *CIT v. Hardeodas Agarwala Trust (1992) 198 ITR 511 (Cal)*. Same view was reiterated in *CIT v. Shahzedanand Charity Trust – (1997) 228 ITR 292 (PH)*, as well as in *CIT v. Devradhan Madhavallal Genda Trust – (1998) 230 ITR 714 (MP)*. Further in view of the judgement of the Hon'ble Supreme Court in the case of *CIT vs. Nagpur Hotel Owners' Association 247 ITR 201*, it can be inferred that the audit report cannot be filed after the assessment is completed. - Also see **Annexure VI**.

42. Debatable issues

42.1 There are several debatable issues in the law relating to taxation of charitable trusts where there is a possibility of taking two different views. A summary of such debatable issues together with the necessary citations is given in **Annexure VI**.

42.2 In this connection attention is invited to the following extract from paragraph 16.3 from the Guidance on Tax Audit under section 44AB of the Income-tax, 1961.

“While furnishing the particulars in Form No.3CD it would be advisable for the tax auditor to consider the following:

- (a)
- (b) If there is any difference in the opinion of the tax auditor and that of the assessee in respect of any information furnished in Form No. 3CD, the tax auditor should state both the view points and also the relevant information in order to enable the tax authority to take a decision in the matter.”

Provisions of Income-tax Act, 1961

(See paragraph No. 7.7)

Income from property held for charitable or religious purposes.

Section 11

- (1) Subject to the provisions of sections 60 to 63, the following income shall not be included in the total income of the previous year of the person in receipt of the income—
 - (a) income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of [fifteen] per cent of the income from such property;
 - (b) income derived from property held under trust in part only for such purposes, the trust having been created before the commencement of this Act, to the extent to which such income is applied to such purposes in India; and, where any such income is finally set apart for application to such purposes in India, to the extent to which the income so set apart is not in excess of [fifteen] per cent of the income from such property;
 - (c) income [derived] from property held under trust—
 - (i) created on or after the 1st day of April, 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and
 - (ii) for charitable or religious purposes, created before the 1st day of April, 1952, to the extent

to which such income is applied to such purposes outside India:

Provided that the Board, by general or special order, has directed in either case that it shall not be included in the total income of the person in receipt of such income;

- (d) income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

Explanation.—For the purposes of clauses (a) and (b),—

- (1) in computing the [fifteen] per cent of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in section 12 shall be deemed to be part of the income;
- (2) if, in the previous year, the income applied to charitable or religious purposes in India falls short of [eighty-five] 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 any amount—
- (i) for the reason that the whole or any part of the income has not been received during that year, or
- (ii) for any other reason,

Then-

- (a) in the case referred to in sub-clause (i), 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, and
- (b) in the case referred to in sub-clause (ii), so much of the income applied to

such purposes in India during the previous year immediately following the previous year in which the income was derived as does not exceed the said amount,

may, at the option of the person in receipt of the income (such option to be exercised in writing before the expiry of the time allowed under sub-section (1) of section 139 for furnishing the return 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, in the case referred to in sub-clause (i), during the previous year in which the income is received or during the previous year immediately following, as the case may be, and, in the case referred to in sub-clause (ii), during the previous year immediately following the previous year in which the income was derived.

(1A) For the purposes of sub-section (1),—

(a) where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—

(i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of such capital gain ;

- (ii) where only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gain as is equal to the amount, if any, by which the amount so utilised exceeds the cost of the transferred asset;
- (b) where a capital asset, being property held under trust in part only for such purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—
 - (i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;
 - (ii) in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

Explanation.—In this sub-section,—

- (i) “appropriate fraction” means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes;
- (ii) “cost of the transferred asset” means the aggregate of the cost of acquisition (as ascertained for the purposes of sections 48 and 49) of the capital asset which is the subject of the transfer and the cost of any improvement thereto within the meaning assigned to

that expression in sub-clause (b) of clause (1) of section 55;

(iii) “net consideration” means the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

(1B) Where any income in respect of which an option is exercised under clause (2) of the *Explanation* to sub-section (1) is not applied to charitable or religious purposes in India during the period referred to in sub-clause (a) or, as the case may be, sub-clause (b), of the said clause, then, such income shall be deemed to be the income of the person in receipt thereof—

(a) in the case referred to in sub-clause (i) of the said clause, of the previous year immediately following the previous year in which the income was received; or

(b) in the case referred to in sub-clause (ii) of the said clause, of the previous year immediately following the previous year in which the income was derived.

(2) Where [eighty-five] per cent of the income referred to in clause (a) or clause (b) of sub-section (1) read with the *Explanation* to that sub-section is not applied, or is not deemed to have been applied, to charitable or 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 the income, provided the following conditions are complied with, namely:—

(a) such person specifies, by notice in writing given to the [Assessing] Officer in the prescribed manner, the purpose for which the income is being accumulated or set apart and the period for which the income is to be

accumulated or set apart, which shall in no case exceed ten years;

- (b) the money so accumulated or set apart is invested or deposited in the forms or modes specified in sub-section (5).

Provided that in computing the period of ten years referred to in clause (a), the period during which the income could not be applied for the purpose for which it is so accumulated or set apart, due to an order or injunction of any court, shall be excluded:

Provided further that in respect of any income accumulated or set apart on or after the 1st day of April, 2001, the provisions of this sub-section shall have effect as if for the words “ten years” at both the places where they occur, the words “five years” had been substituted.

Explanation.—Any amount credited or paid, out of income referred to in clause (a) or clause (b) of sub-section (1), read with the Explanation to that sub-section, which is not applied, but is accumulated or set apart, to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

- (3) Any income referred to in sub-section (2) which—
 - (a) is applied to purposes other than charitable or religious purposes as aforesaid or ceases to be accumulated or set apart for application thereto, or
 - (b) ceases to remain invested or deposited in any of the forms or modes specified in sub-section (5), or
 - (c) is not utilized for the purpose for which it is so accumulated or set apart during the period referred to

in clause (a) of that sub-section or in the year immediately following the expiry thereof,

- (d) is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of section 10,]

shall be deemed to be the income of such person of the previous year in which it is so applied or ceases to be so accumulated or set apart or ceases to remain so invested or deposited or [credited or paid or], as the case may be, of the previous year immediately following the expiry of the period aforesaid.

- (3A) Notwithstanding anything contained in sub-section (3), where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in accordance with the provisions of clause (b) of sub-section (2) cannot be applied for the purpose for which it was accumulated or set apart, the Assessing 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; and thereupon the provisions of sub-section (3) shall apply as if the purpose specified by such person in the application under this sub-section were a purpose specified in the notice given to the Assessing Officer under clause (a) of sub-section (2).

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of sub-section (3) of section 11.

Provided further that in case the trust or institution, which has invested or deposited its income in accordance with the provisions of clause (b) of sub-section (2), is dissolved, the

Assessing Officer may allow application of such income for the purposes referred to in clause (d) of sub-section (3) in the year in which such trust or institution was dissolved.

- (4) For the purposes of this section “property held under trust” includes a business undertaking so held, and where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of this Act relating to assessment; and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.
- (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 of business, unless the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution, and separate books of account are maintained by such trust or institution in respect of such business.
- (5) The forms and modes of investing or depositing the money referred to in clause (b) of sub-section (2) shall be the following, namely :—
- (i) investment in savings certificates as defined in clause (c) of section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government;
 - (ii) deposit in any account with the Post Office Savings Bank;
 - (iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business

of banking (including a co-operative land mortgage bank or a co-operative land development bank).

Explanation.—In this clause, “scheduled bank” means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

- (iv) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);
- (v) investment in any security for money created and issued by the Central Government or a State Government;
- (vi) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;
- (vii) investment or deposit in any public sector company:

Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company,—

- (A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public

sector company ceases to be a public sector company;

- (B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;
- (viii) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction under clause (viii) of sub-section (1) of section 36;
- (ix) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes and which is eligible for deduction under clause (viii) of sub-section (1) of section 36;
- (ix a) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation.—For the purposes of this clause,—

- (a) “long-term finance” means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;
- (b) “public company” shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956);
- (c) “urban infrastructure” means a project for providing potable water supply, sanitation and sewerage,

drainage, solid waste management, roads, bridges and flyovers or urban transport;

- (x) investment in immovable property.

Explanation.—“Immovable property” does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;

- (xi) deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964);
- (xii) any other form or mode of investment or deposit as may be prescribed.

Section 12 - Income of trusts or institutions from contributions

- (1) Any voluntary contributions received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes (not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution) shall for the purposes of section 11 be deemed to be income derived from property held under trust wholly for charitable or religious purposes and the provisions of that section and section 13 shall apply accordingly.
- (2) The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any person referred to in clause (a) or clause (b) or clause (c) or clause (cc) or clause (d) of sub-section (3) of section 13, shall be deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax notwithstanding the provisions of sub-section (1) of section 11.

Explanation.—For the purposes of this sub-section, the expression “value” shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person referred to in clause (a) or clause (b) or clause (c) or clause (cc) or clause (d) of sub-section (3) of section 13.

- (3) Notwithstanding anything contained in section 11, any amount of donation received by the trust or institution in terms of clause (d) of sub-section (2) of section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, or which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of sub-section (5C) of section 80G and not transferred to the Prime Minister’s National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

Section 12A - Conditions for applicability of sections 11 and 12

- (1) The provisions of section 11 and section 12 shall not apply in relation to the income of any trust or institution unless the following conditions are fulfilled, namely:—
- (a) the person in receipt of the income has made an application for registration of the trust or institution in the prescribed form and in the prescribed manner to the Commissioner before the 1st day of July, 1973, or before the expiry of a period of one year from the date of the creation of the trust or the establishment of the institution, [whichever is later and such trust or institution is registered under section 12AA.

Provided that where an application for registration of the trust or institution is made after the expiry of the period aforesaid, the provisions of sections 11 and 12 shall apply in relation to the income of such trust or institution,—

- (i) from the date of the creation of the trust or the establishment of the institution if the Commissioner is, for reasons to be recorded in writing, satisfied that the person in receipt of the income was prevented from making the application before the expiry of the period aforesaid for sufficient reasons;
- (ii) from the 1st day of the financial year in which the application is made, if the Commissioner is not so satisfied:

Provided further that the provisions of this clause shall not apply in relation to any application made on or after the 1st day of June, 2007;

- (aa) the person in receipt of the income has made an application for registration of the trust or institution on or after the 1st day of June, 2007 in the prescribed form and manner to the Commissioner and such trust or institution is registered under section 12AA;
- (b) where the total income of the trust or institution as computed under this Act without giving effect to *the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to income-tax in any previous year*, the accounts of the trust or institution for that year have been audited by an accountant as defined in the *Explanation* below sub-section (2) of section 288 and the person in receipt of the income furnishes along with the return of income for the relevant assessment year the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.
- (2) Where an application has been made on or after the 1st day of June, 2007, the provisions of sections 11 and 12 shall apply in relation to the income of such trust or institution from the assessment year immediately following the financial year in which such application is made.

Section 12AA - Procedure for registration

- (1) The Commissioner, on receipt of an application for registration of a trust or institution made under clause (a) or clause (aa) of sub-section (1) of section 12A, shall—
- (a) call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf; and
 - (b) after satisfying himself about the objects of the trust or institution and the genuineness of its activities, he—
 - (i) shall pass an order in writing registering the trust or institution;
 - (ii) shall, if he is not so satisfied, pass an order in writing refusing to register the trust or institution,

and a copy of such order shall be sent to the applicant :

Provided that no order under sub-clause (ii) shall be passed unless the applicant has been given a reasonable opportunity of being heard.

- (1A) All applications, pending before the Chief Commissioner on which no order has been passed under clause (b) of sub-section (1) before the 1st day of June, 1999, shall stand transferred on that day to the Commissioner and the Commissioner may proceed with such applications under that sub-section from the stage at which they were on that day.
- (2) Every order granting or refusing registration under clause (b) of sub-section (1) shall be passed before the expiry of six months from the end of the month in which the application was received under clause (a) or clause (aa) of sub-section (1) of section 12A.
- (3) Where a trust or an institution has been granted registration under clause (b) of sub-section (1) and subsequently the

Commissioner is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, he shall pass an order in writing cancelling the registration of such trust or institution:

Provided that no order under this sub-section shall be passed unless such trust or institution has been given a reasonable opportunity of being heard.

Section 13 – Section 11 not to apply in certain cases.

- (1) Nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof—
- (a) any part of the income from the property held under a trust for private religious purposes which does not enure for the benefit of the public;
 - (b) in the case of a trust for charitable purposes or a charitable institution created or established after the commencement of this Act, any income thereof if the trust or institution is created or established for the benefit of any particular religious community or caste;
 - (c) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof—
 - (i) if such trust or institution has been created or established after the commencement of this Act and under the terms of the trust or the rules governing the institution, any part of such income enures, or
 - (ii) if any part of such income or any property of the trust or the institution (whenever created or established) is during the previous year used or applied,
directly or indirectly for the benefit of any person referred to in sub-section (3) :

Provided that in the case of a trust or institution created or established before the commencement of this Act, the provisions of sub-clause (ii) shall not apply to any use or application, whether directly or indirectly, of any part of such income or any property of the trust or institution for the benefit of any person referred to in sub-section (3), if such use or application is by way of compliance with a mandatory term of the trust or a mandatory rule governing the institution:

Provided further that in the case of a trust for religious purposes or a religious institution (whenever created or established) or a trust for charitable purposes or a charitable institution created or established before the commencement of this Act, the provisions of sub-clause (ii) shall not apply to any use or application, whether directly or indirectly, of any part of such income or any property of the trust or institution for the benefit of any person referred to in sub-section (3) in so far as such use or application relates to any period before the 1st day of June, 1970;

- (d) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof, if for any period during the previous year—
- (i) any funds of the trust or institution are invested or deposited after the 28th day of February, 1983 otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11; or
 - (ii) any funds of the trust or institution invested or deposited before the 1st day of March, 1983 otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11 continue to remain so invested or deposited after the 30th day of November, 1983; or
 - (iii) *any shares in a company, other than—*
 - (A) *shares in a public sector company ;*

(B) *shares prescribed as a form or mode of investment under clause (xii) of sub-section (5) of section 11,*

are held by the trust or institution after the 30th day of November, 1983:

Provided that nothing in this clause shall apply in relation to—

- (i) any assets held by the trust or institution where such assets form part of the corpus of the trust or institution as on the 1st day of June, 1973;
- (ia) any accretion to the shares, forming part of the corpus mentioned in clause (i), by way of bonus shares allotted to the trust or institution;
- (ii) any assets (being debentures issued by, or on behalf of, any company or corporation) acquired by the trust or institution before the 1st day of March, 1983;
- (ia) 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, 1993, whichever is later;
- (iii) any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year commencing on the 1st day of April, 1984 or any subsequent assessment year.

Explanation.—Where the trust or institution has any other income in addition to profits and gains of business, the provisions of clause (iii) of this proviso shall not apply unless the trust or institution maintains separate books of account in respect of such business.

Explanation.—For the purposes of sub-clause (ii) of clause (c), in determining whether any part of the income or any property of any 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), in so far as such use or application relates to any period before the 1st day of July, 1972, no regard shall be had to the amendments made to this section by section 7 other than sub-clause (ii) of clause (a) thereof of the Finance Act, 1972.

- (2) Without prejudice to the generality of the provisions of clause (c) [and clause (d)] of sub-section (1), the income or the property of the trust or institution or any part of such income or property shall, for the purposes of that clause, be deemed to have been used or applied for the benefit of a person referred to in sub-section (3),—
- (a) if any part of the income or property of the trust or institution is, or continues to be, lent to any person referred to in sub-section (3) for any period during the previous year without either adequate security or adequate interest or both;
 - (b) if any land, building or other property of the trust or institution is, or continues to be, made available for the use of any person referred to in sub-section (3), for any period during the previous year without charging adequate rent or other compensation;
 - (c) if any amount is paid by way of salary, allowance or otherwise during the previous year to any person referred to in sub-section (3) out of the resources of the trust or institution for services rendered by that person to such trust or institution and the amount so paid is in excess of what may be reasonably paid for such services;
 - (d) if the services of the trust or institution are made available to any person referred to in sub-section (3)

during the previous year without adequate remuneration or other compensation;

- (e) if any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in sub-section (3) during the previous year for consideration which is more than adequate;
- (f) if any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in sub-section (3) during the previous year for consideration which is less than adequate;
- (g) if any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in sub-section (3);

Provided that this clause shall not apply where the income, or the value of the property or, as the case may be, the aggregate of the income and the value of the property, so diverted does not exceed one thousand rupees;

- (h) if any funds of the trust or institution are, or continue to remain, invested for any period during the previous year (not being a period before the 1st day of January, 1971), in any concern in which any person referred to in sub-section (3) has a substantial interest.

(3) The persons referred to in clause (c) of sub-section (1) and sub-section (2) are the following, namely :—

- (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, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds fifty thousand rupees;
- (c) where such author, founder or person is a Hindu undivided family, a member of the family;

- [(cc) any trustee of the trust or manager (by whatever name called) of the institution;]
 - (d) any relative of any such author, founder, person, [member, trustee or manager] as aforesaid;
 - (e) any concern in which any of the persons referred to in clauses (a), (b), (c), [(cc)] and (d) has a substantial interest.
- (4) Notwithstanding anything contained in clause (c) of sub-section (1) [but without prejudice to the provisions contained in clause (d) of that sub-section], in a case where the aggregate of the funds of the trust or institution invested in a concern in which any person referred to in sub-section (3) has a substantial interest, does not exceed five per cent of the capital of that concern, the exemption under section 11 [or section 12] shall not be denied in relation to any income other than the income arising to the trust or the institution from such investment, by reason only that the [funds] of the trust or the institution have been invested in a concern in which such person has a substantial interest.
- (5) Notwithstanding anything contained in clause (d) of sub-section (1), where any assets (being debentures issued by, or on behalf of, any company or corporation) are acquired by the trust or institution after the 28th day of February, 1983 but before the 25th day of July, 1991, the exemption under section 11 or section 12 shall not be denied in relation to any income other than the income arising to the trust or the institution from such assets, by reason only that the funds of the trust or the institution have been invested in such assets if such funds do not continue to remain so invested in such assets after the 31st day of March, 1992.
- (6) Notwithstanding anything contained in sub-section (1) or sub-section (2), but without prejudice to the provisions contained in sub-section (2) of section 12, in the case of a charitable or religious trust running an educational institution or a medical institution or a hospital, the exemption under section 11 or

section 12 shall not be denied in relation to any income, other than the income referred to in sub-section (2) of section 12, by reason only that such trust has provided educational or medical facilities to persons referred to in clause (a) or clause (b) or clause (c) or clause (cc) or clause (d) of sub-section (3).

- (7) *Nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of that section.*

Explanation 1. —For the purposes of sections 11, 12, 12A and this section, “trust” includes any other legal obligation and for the purposes of this section “relative”, in relation to an individual, means—

- (i) spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) any lineal ascendant or descendant of the individual;
- (v) any lineal ascendant or descendant of the spouse of the individual;
- (vi) spouse of a person referred to in sub-clause (ii), sub-clause (iii), sub-clause (iv) or sub-clause (v);
- (vii) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.

Explanation 2.—A trust or institution 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 within the meaning of clause (b) of sub-section (1).

Explanation 3.—For the purposes of this section, a person shall be deemed to have a substantial interest in a concern,—

- (i) in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty 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 sub-section (3);
- (ii) in the case of any other concern, if such person is entitled, or such person and one or more of the other persons referred to in sub-section (3) are entitled in the aggregate, at any time during the previous year, to not less than twenty per cent of the profits of such concern.

Section 115BBC - Anonymous donations to be taxed in certain cases

- (1) Where the total income of an assessee, being a person in receipt of income on behalf of any university or other educational institution referred to in sub-clause (iiia) or sub-clause (vi) or any hospital or other institution referred to in sub-clause (iiiae) or sub-clause (via) or any fund or institution referred to in sub-clause (iv) or any trust or institution referred to in sub-clause (v) of clause (23C) of section 10 or any trust or institution referred to in section 11, includes any income by way of any anonymous donation, the income-tax payable shall be the aggregate of -
 - (i) the amount of income-tax calculated on the income by way of any anonymous donation, at the rate of thirty per cent; and
 - (ii) the amount of income-tax with which the assessee would have been chargeable had his total income been

reduced by the amount of income referred to in clause (i).

- (2) The provisions of sub-section (1) shall not apply to any anonymous donations received by -
 - (a) any trust or institution created or established wholly for religious purposes;
 - (b) any trust or institution created or established wholly for religious and charitable purposes other than any anonymous donation made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution.
- (3) For the purposes of this section, “anonymous donation” means any voluntary contribution referred to in sub-clause (iia) of clause (24) of section 2, where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed.

ANNEXURE - II

Relevant Rules and Form under the Income-tax Rules, 1962

(See Paragraph No. 7.7)

Rule 17

Notice for accumulation of income by charitable or religious trust or institution or association referred to in clauses (21) and (23) of section 10

The notice to be given to the Assessing Officer or the prescribed authority under sub-section (2) of section 11 or under the said provisions as applicable under clause (21) or clause (23) of section 10 shall be in Form No.10 and shall be delivered before the expiry of the time allowed under sub-section (1) of section 139, for furnishing the return of income.

Rule 17A

Application for registration of charitable or religious trusts, etc.

An application under clause (a) of section 12A for registration of a charitable or religious trust or institution shall be made in duplicate in Form No. 10A and shall be accompanied by the following documents, namely:-

- (a) where the trust is created, or the institution is established, under an instrument, the instrument in original, together with one copy thereof; and where the trust is created, or the institution is established, otherwise than under an instrument, the document evidencing the creation of the trust or the establishment of the institution, together with one copy thereof:

Provided that if the instrument or document in original cannot conveniently be produced, it shall be open to the Chief Commissioner or Commissioner to accept a certified copy in lieu of the original;

- (b) where the trust or institution has been in existence during any year or years, prior to the financial year in which the application for registration is made, two copies of the accounts of the trust or institution relating to such prior year or years (not being more than three years immediately preceding the year in which the said application is made) for which such accounts have been made up.

Rule 17B

Audit report in the case of charitable or religious trusts, etc.

The report of audit of the accounts of a trust or institution, which is required to be furnished under clause (b) of section 12A, shall be in Form No.10B.

Rule 17C

Forms or modes of investment or deposits by a charitable or religious trust or institution

The forms and modes of investment or deposits under clause (xii) of sub-section (5) of section 11 shall be the following, namely:-

- (i) investment in the units issued under any scheme of the mutual fund referred to in clause (23D) of section 10 of the Income-tax Act, 1961;
- (ii) any transfer of deposits to the Public Account of India;
- (iii) deposits made within an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both;
- (iv) investment by way of acquiring equity shares of a depository as defined in clause (e) of sub-section (1) of section 2 of the Depositories Act, 1996 (22 of 1996).

Form No. 10

[See Rule 17]

(Vide Paragraph No. 7.6)

Notice to the Assessing Officer/Prescribed Authority under section 11(2) of the Income-tax Act, 1961

To

The Assessing Officer/Prescribed Authority

.....
.....

I,, on behalf of (name of the trust/institution/association) hereby bring to your notice that it has been decided by a resolution passed by the trustees/governing body, by whatever name called, on (copy enclosed) that, out of the income of the trust/institution/association for the previous year(s), relevant to the assessment year 20..... - 20..... and subsequent previous year(s), an amount of Rs..... per cent of the income of the trust/institution/association/such sum as is available at the end of the previous year(s) should be accumulated or set apart till the previous year(s) ending in order to enable the trustees/governing body by whatever name called, to accumulate sufficient funds for carrying out the following purposes of the trust/ association/institution:-

(1).....

(2).....

2. Before expiry of six months commencing from the end of each previous year, the amount so accumulated or set apart has been/will be invested or deposited in any one or more of the forms or modes specified in sub-section (5) of section 11.

3. Copies of the annual accounts of the trust/institution/association along with details of investment (including deposits) and utilisation, if any, of the money so accumulated or set apart will be

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furnished to you before the expiry of six months commencing from the end of each relevant previous year.

4. It is requested that, in view of our complying with the conditions laid down in section 11(2) of the Income-tax Act, 1961, the benefit of that section may be given in the assessments of the trust/exempting the income in respect of the trust/institutions/association in respect of the incomes accumulated or set apart as mentioned above.

Date.....

Signature.....

Designation.....

Address.....

Notes

1. This notice should be signed by a trustee/principal officer.
2. Delete the inappropriate words.

ANNEXURE –III

Section II : Auditing and Assurance Standards

(See paragraph 5.3)

Preface to the Statements on Standard Auditing Practices

- AAS 1 Basic Principles Governing an Audit
- AAS 2 Objective and Scope of the Audit of Financial Statements
- AAS 3 Documentation
- AAS 4 The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements
- AAS 5 Audit Evidence
- AAS 6 Risk Assessments and Internal Control
- AAS 7 Relying Upon the Work of an Internal Auditor
- AAS 8 Audit Planning
- AAS 9 Using the Work of an Expert
- AAS 10 Using the Work of Another Auditor
- AAS 11 Representations by Management
- AAS 12 Responsibility of Joint Auditors
- AAS 13 Audit Materiality
- AAS 14 Analytical Procedures
- AAS 15 Audit Sampling
- AAS 16 Going Concern
- AAS 17 Quality Control for Audit work
- AAS 18 Auditing of Accounting Estimates

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- AAS 19 Subsequent Events
- AAS 20 Knowledge of the Business
- AAS 21 Consideration of Laws and Regulations in an Audit of Financial Statements
- AAS 22 Initial Engagements- Opening Balances
- AAS 23 Related Parties
- AAS 24 Audit Considerations Relating to Entities Using Service Organisations
- AAS 25 Comparatives
- AAS 26 Terms of Audit Engagement
- AAS 27 Communications of Audit Matters with Those Charged with Governance
- AAS 28 The Auditor's Report on Financial Statements
- AAS 29 Audit in a Computer Information Systems Environment
- AAS 30 External Confirmations
- AAS 31 Engagements to Compile Financial Information
- AAS 32 Engagements to Perform Agreed-Upon Procedures Regarding Financial Information
- AAS 33 Engagements to Review Financial Statements
- AAS 34 Audit Evidence-Additional Consideration for Specific Items
- AAS 35 The Examination of Prospective Financial Information

ANNEXURE – IV**Judicial decisions explaining the scope of the terms “charitable purpose” and related issues.**

(See Paragraph 8.8)

1. *In Khemraj Nemchand Shrishrimal Charitable Trust v. CIT (1998) 231 ITR 43* the MP High Court held that a charitable institution which was constituted so as to appraise the Government of the various difficulties being faced by the agriculturists in their day to day life could be entitled to exemption, but a donation with a direction for the specific purpose of organizing a kisan rally was held to be the income of the society not entitled for exemption. However, the learned author *S. Rajaratnam* in his treatise on Landmark Cases, 2007, Vol. 1, page 670 has expressed a dissenting note, “presuming that conducting such rally is outside the objects, the amount received by it specifically for the rally whether spent or not would have a separate identity and need not vitiate the exemption. If the promotion of the rally is not a permissible object and trust funds are used, it is a case where there is misapplication of the funds. But where the donation itself is for an object not covered by the trust deed, it is a case of a constructive trust, distinct and different for the receipt, with tax incidence on the surplus, if any, according to law, so that it need not have been taken as income of the trust.”
2. It is to be seen that the actual objects carried out alone are relevant and not the total objects of the Society, whether carried on or not. Held in *Arunchal Pradesh Forest Corporation Ltd. v. Asst. CIT (2007) 290 ITR 139 (Gauhati)* : Government Corporation to promote scheduled tribes is specifically exempt under section 10(26D) of the Act. The objection of revenue was that the forest corporation could not directly come under the exemption for the reason that the corporation was formed for economic use and improvement of forest resources and not for existing scheduled tribes.

Since the corporation was catering to an area, which has 98% of its population belonging to scheduled tribes and it was formed on the recommendation of a Parliamentary Committee on scheduled castes and scheduled tribes, it was held in *Arunchal Pradesh Forest Corporation Ltd. v. Asst. CIT (2007) 290 ITR 139 (Gauhati)*, that it should qualify for exemption.

3. Educational institution : Conditions for exemption for educational trust are more liberal, held in *A.R.R. Trust v. Asst. CIT (2006) 280 ITR (AT) 152 (Chennai)* : Held in *CWT v. Kikabi's Educational Trust (2000) 242 ITR 697 (Mad)* "Where business income is not ruled out for charitable purpose, there is no reason at all why exemption should be denied, when the purpose is charitable". In this case an objection was also taken on the ground that there is an infringement of the conditions under section 13(2)(b), which bars investment of the funds of the trust with persons having substantial interest. The High Court rejected this objection because it was an educational trust, and that there is no application of section 13. The high court also found that section 13(4) gives certain exceptions to such investments within the limits.
4. Religious object – How far it would affect donations under section 80G.

The Supreme Court in *Upper Ganges Sugar Mills Ltd. v. CIT (1997) 227 ITR 57* found that section 80G of the Income-tax Act, 1961, sets out the deductions to be made, in accordance with and subject to its provisions, in computing the total income of an assessee in respect of donations to certain funds, charitable institutions, etc. It applies, by reason of sub-section (5) thereof, to any other fund or any institution to which the section applies [sub-section (2)(a)(iv)] if it is established in India "for a charitable purpose" and fulfils the condition, inter alia, that it "is not expressed to be for the benefit of any particular religious community or caste". Explanation 3 states, "In this section, 'charitable purpose'

does not include any purpose the whole or substantially the whole of which is of a religious nature." Explanation 3 takes note of the fact that an institution or fund established for a charitable purpose may have a number of objects. If any one of these objects is wholly, or substantially wholly, of a religious character, the institution or fund falls outside the scope of section 80G and a donation to it does not secure the advantage of the deduction that it gives. Explanation 3 does not require the ascertainment of whether the whole or substantially the whole of the institution or fund's charitable purpose is of a religious nature. If it did, it would read differently. It requires the ascertainment of whether there is one purpose, within the institution or fund's overall charitable purpose which is wholly, or substantially wholly, of a religious nature. Held accordingly, affirming the decision of the Calcutta High Court in *CIT v. Upper Ganges Sugar Mills Ltd. (1985) 154 ITR 308*, that clause 2(h) of the trust deed in question which permitted the trustees to support prayer halls and places of worship set out a purpose, the whole or substantially the whole of which was of a religious nature. Therefore, the trust and the donation by the assessee to it fell outside the scope of section 80G.

5. In *CIT v. Hazarath Pir Shah-E-Alam Roza Estate Trust (2002) 256 ITR 193 (Guj)*, it was held that a trust, the income of which was to be utilized for the maintenance of a darga and a roza, created under a sanad and grants during the British regime and treated as public trust after due enquiry under the Bombay Trusts Act, 1950, cannot but be treated as public trust entitled to exemption under section 11.

6. Issue of registration for a valid trust

Oral endowment by a hindu for public charitable purpose of any immovable property is a valid trust. Held in *Kuldip Chand v. Advocate-General to the Government of HP (2003) 279 ITR 561 (All.)*. It is an established proposition in Hindu Law, that an immovable property endowed by a hindu for public

charitable purpose does not require registered deed. Even an oral endowment will be valid as has been held *Kuldip Chand v. Advocate-General to the Government of HP (2003) 279 ITR 561 (All.)*. In the facts of the case, there was also declaratory decree in favour of the trust by a Civil Court and mutation in favour of the trust were also carried out in the revenue records, so that it was found that the income from the property has to be treated as that of the trust and that it cannot, therefore, be treated as that of the donor merely because the property stood in her name in absence of registration.

7. Computation of income eligible for exemption: It is settled law that the profit and loss account should be prepared on commercial principles and not under the Income-tax Act. It is only the claim for exemption which is to be computed under the Income-tax Act. With the prescription of audit report in section 12A(b) [now section 12A(i)(b)] in form 10B the auditor is required to compute the income eligible for exemption under section 11 and also to state the expenditure incurred and investment made in violation of section 13(3).
8. Computation of income on commercial principles and not head-wise as per statutory provisions: The Supreme Court in *CIT v Programme for Community Organisation (2001) 248 ITR 1 (SC)* had approved the Kerala High Court decision in the same case (1997) 228 ITR 620 (Ker) as to the manner of computation. Income has to be computed on commercial basis and not head-wise on statutory basis. Expenditure would be a charge on the income, while the net income along with donations other than corpus donations, will form the eligible base out of which the assessee is expected to apply 85% (earlier 75%). This has also been explained in Board Circular No. 5P, dated 19.06.1998.
9. Fund-raising activity
A charity is exempt on all its income notwithstanding some fund-raising activity: Voluntary agencies and mutual associations often raise funds for their activities, not only

from donations voluntarily received, but by several other means and special efforts e.g. by sponsoring entertainments, publishing souvenirs or promoting games and lotteries. The issue arose whether the amount thus collected from these activities could be treated as income. The Andhra High Court in *CIT v. SRMT Staff Association (1996) 221 ITR 234* may be noted. In this case income from publication of souvenir was sought to be taxed by the Income-tax Department on the ground first that the association was not a charitable institution and secondly that if these are voluntary contributions and not advertising charges, even then these would be taxable under section 2(24)(iia). Both these arguments were not accepted by the Court. The decision of the *Bombay High Court in CIT v. Trustees of Visha Nima Charity Trust (1982) 138 ITR 564* was relied upon.

10. Business income for charities : The Supreme Court in *Assistant Commissioner of Income-tax v. Thanthi Trust (2001) 247 ITR 785 (SC)* has laid down the following principles regarding business income for charities.

A public charitable trust may hold a business as part of its corpus. It may carry on a business which it does not hold as part of its corpus. But the distinction has no consequence in so far as section 13(1)(bb) is concerned. Section 13(1)(bb) will apply to a public charitable trust for the relief of the poor, education or medical relief that carries on a business, regardless of whether or not that business is held by the trust in trust, i.e., as part of its corpus : even a business that is held by such a trust as a part of its corpus is carried on by the trust and, therefore, section 13(1)(bb) will apply to such a trust. The words used in section 13(1)(bb) are wide enough to control not only the profit from an activity carried on in the course of the actual carrying out of the purpose of the trust or institution but also income from the corpus of the trust property if the corpus of the trust includes a business. The exemption under section 11 will not be available unless the business is carried on in the course of actually accomplishing the primary purpose of the trust ; the business must,

therefore, be carried on in the course of the actual accomplishment of relief of the poor, education or medical relief. Trusts and institutions are separately dealt with in the Income-tax Act. The expressions refer to entities differently constituted.

The scope of sub-section (4A) of section 11, as amended in 1992, is more beneficial to a trust or institution than the scope of the sub-section before the amendment. As it stands amended in 1992, all that is required for the business income of a trust or institution to be exempt from tax is that the business should be incidental to the attainment of the objectives of the trust or institution. A business whose income is utilised by the trust or the institution for the purposes of achieving the objectives of the trust or the institution is a business which is incidental to the attainment of the objectives of the trust or institution. In the case of ambiguity in the language employed the provision must be construed in a manner that benefits the assessee.

11. Agri-horticultural business – Scope of exemption

Director of Income-tax (Exemptions) v. Agri-Horticultural Society (2005) 273 ITR 198 (Mad) : The assessee was a society engaged in the business of purchase and sale of agri-horticultural products like manure, seeds, garden implements, flower pots, etc., having engaged more than 259 members and 54 employees. The assessee/society was established, registered and was functioning for a charitable purpose within the meaning of section 2(15) of the Income-tax Act, 1961. However, on the ground that it had not conducted a flower show for the last ten years and it was using the premises for shooting of films and television serials, the assessing authority disputed the status of the assessee/society as of charitable nature and denied the exemption claimed by the assessee. The Tribunal held that the assessee was entitled to exemption. On appeal to the High Court : Held, dismissing the appeal, that the fact that the assessee developed various kinds of plants that restored

environmental balance and also helped in the conservation of various plants in the State of Tamil Nadu was not in dispute. Similarly, the fact that the assessee-society was growing plants, which were sold in pots and also developed seeds, garden implements, manure, etc., by engaging 54 employees was also not disputed. If that be so, the assessee had to receive a minimum sale consideration for giving payment to the employees and such act of the assessee-society by itself, could not be construed as commercial in nature. Similarly the fact that it had not conducted flower shows for the past ten years had not changed the character of the charitable object of the society as defined under section 2(15). The definition in section 2(15) is inclusive. An inclusive definition widens the etymological meaning of the expression or term including therein that which would ordinarily not be comprehended therein. The words used in an inclusive definition denote extension and cannot be treated as restricted in any sense. While dealing with an inclusive definition it would be inappropriate to put a restrictive interpretation upon terms of wider denotation. Therefore, even assuming that it had charged for shooting movies and television serials, etc., it only amounted to corpus donation, but would not change the charitable object and purpose of the assessee. The assessee was entitled to exemption under section 11.

12. Outstanding realised invested in building for hospital : *S. Rm. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636 (SC)* : In this case the charitable trust, had resolved on March 1, 1963, for the accumulation of its income for ten years commencing from April 13, 1961, for various charitable purposes. For the year ending April 12, 1970, an amount of Rs 8 lakhs which was shown as an advance to firm was shown as having been realized and invested in a building for the purpose of a hospital : Held, that the sum of Rs. 8 lakhs was exempt from tax for the assessment year 1970-71 under section 11(1)(a) and had not to be invested in Government securities.

13. Repayment of loan for investment is application: Construction of a building is a permissible investment under section 11(5) of the Income-tax Act, so long as it is for fulfilling the objectives of the institution and as such would qualify as income applied for charitable purposes. But what would happen if there is a difference on account of part of the construction cost met by a loan and later repaid? Will such repayment qualify as application so as to form part of 85 per cent of income of the current year expected to be applied during the year for charitable purposes? This has been answered by the Kerala High Court in *CIT v. Janmabhoomi Press Trust (2000) 242 ITR 703 ITR 703 (Kar)*: Held that repayment should be treated as application, following the decisions in *CIT v Kannika Parameswarei Devasthanam and Charities (1928) 133 ITR 779 (Mad)* and *CIT v. St. George Forana Church (1988) 170 ITR 62 (Ker)*.
14. The Supreme Court in *Commissioner of Sales Tax v. Sai Publication Fund (2002) 258 ITR 70 (SC)* considered the issue whether the trust is a dealer under the Maharashtra tax laws (Levy Amendment and Repeal Act, 1989). In this case the assessee was carrying on the activity in publication and sale of books, pamphlets, booklets, photos, stickers, etc., an organized activity but without profit motive. The Supreme Court found that profit motive is not essential for business. But at the same time a person cannot be treated as a dealer for sales tax purposes, unless such business was carried with profit motive. Held, "Where the activity that is carried on is charitable or is incidental or ancillary to a charitable object without profit motive and without an independent intention to carry on business, it need not even be construed as business, so as to make the institution liable as a dealer, who carried on a business".
15. Depreciation: Depreciation under section 32 is allowable on all capital assets put to use by any organization for the purposes of its business or profession. Due to the use of the phrase "business or profession", there has been a controversy, whether such a depreciation could be claimed

by a charitable organization, when there is no business, albeit there was no dispute that such a depreciation would be allowed in the case of business capital assets, where the charity is carrying on any such business activity. This issue too has been settled by the Courts in favor of the charity, as per landmark judgments given below.

- (a) Allowability of depreciation on fixed assets used for charitable purposes: The allowability of depreciation has been settled in favor of the assessee trusts in several cases, viz. that depreciation has to be allowed while computing the net income before considering its application to charitable purposes. *CIT v. Society of Sisters of St. Anne (1984) 146 ITR 28 (Ker)*, *CIT v. Raipur Pallottine Society (1989) 180 ITR 579 (MP)*; *CIT v. Seth Manilal Ranchchoddas Vishram Bhavan Trust (1992) 198 ITR 598 (Guj)* and *CIT v. Bhoruka Public Welfare Trust (1999) 240 ITR 513 (Cal)*.
- (b) Assets donated in kind : *CIT v. Munisuvarat Jain (1994) Tax LR 1084 (Bom)* : In this case depreciable asset had been received as a gift, the actual cost for purposes of depreciation would be the value of the property, because depreciation as a charge on current income is required to be provided, whether the property is acquired out of own funds or out of voluntary donations. This judgment reiterates the principle that depreciation has to be allowed on commercial principles and not with reference to section 32 of the Income-tax Act, which has no application in computation of income of a charity.

Un-absorbed depreciation brought forward from the past: It was held in *CIT v. Institute of Banking (2003) 264 ITR 110 (Bom)* following an earlier judgment of Bombay High Court in *Director of Income-tax (Exemption) v. Framjee Cawasjee Institute (1993) 109 CTR 463 (Bom)* that it should be treated as deductible expenditure in the year of surplus, removing the common belief that since cost of asset had been allowed

as a business deduction while it has been allowed as application of income unabsorbed depreciation could not be claimed as a deduction. The high court further found that on the same reasoning even past expenditure in excess of income could be adjusted. It tantamounts to past losses being allowed as a deduction.

16. Carry forward of previous years deficit: Since the trust is not a business organization and its income cannot be computed under sections 28 to 44DB, question arises whether it would be entitled to carry forward of deficit as there is no specific provision for such carry forward in the Act and the provisions of sections 70 to 80 would also not be applicable to such deficit. The matter came up before the Gujrat High Court in *Commissioner of Income-tax v. Shri Plot Swetamber Murti Pujak Jain Mandal (1995) 211 ITR 293 (Guj)*; *Following CIT v. Maharana of Mewar Charitable Foundation (1987) 164 ITR 439 (Raj)* Held : that a bare perusal of section 11 of the Income-tax Act, 1961, shows that the income derived from property held under trust wholly for charitable or religious purposes to the extent to which such income is applied to such purposes in India is to be excluded for the purposes of computing the income of the trust for the purpose of assessment. There are no words of limitation in this section providing that the income should have been applied for charitable or religious purposes only in the year in which the income had arisen. The word "apply" means "to put to use" or "to turn to use" or "to make use" or "to put to practical use". Having regard to the provisions of section 11 of the Act, it is clear that when the income of a trust is used or put to use to meet the expenses incurred for religious or charitable purposes, it is applied for charitable or religious purposes. The application of the income for charitable or religious purposes takes place in the year in which the income is adjusted to meet the expenses incurred for charitable or religious purposes. In other words, even if expenses for charitable and religious purposes have been incurred for the earlier year and the said expenses are adjusted against the

income of a subsequent year, the income of that year can be said to have been applied for charitable and religious purposes in the year in which the expenses incurred for charitable and religious purposes had been adjusted. There is nothing in the language of section 11(1)(a) of the Act to indicate that the expenditure incurred in the earlier year cannot be met out of the income of the subsequent year and utilization of such income for meeting the expenditure of the earlier year, would not amount to such income being applied for charitable or religious purposes. Income derived from trust property has to be determined on commercial principles and if commercial principles for determining the income are applied, it is but natural that the adjustment of the expenses incurred by the trust for charitable and religious purposes in the earlier year against income earned by the trust in the subsequent year will have to be regarded as application of income of the trust for charitable and religious purposes in the subsequent year in which such adjustment has been made having regard to the benevolent provisions contained in section 11 of the Act and will have to be excluded from the income of the trust under section 11(1)(a).

18. Anonymous donation – Identity of the donors

The Delhi High Court in *Director of I.T (Exemption) v. Bharat Kalyan Prastishthan (2002) 257 ITR 609 (Delhi)* was concerned with the issue of anonymous donations. In this case, the Assessing Officer wanted the donors to be produced, so as to verify the identity of the donors. After all, where any credit is not explained, it is treated as income. Voluntary contributions at any rate are treated as income. All that a charity is expected to do in a matter relation to such donation is that such donations along with other income are applied for charitable purposes to the extent required by law, unless it is a corpus donation. It stands to reason that there is need for satisfying the Assessing Officer that donations claimed to be corpus donations are established to be such corpus donations by identification of the donors.

Relevant Circulars**(See paragraph Nos. 22.1 and 22.4)****1. Circulars relating to paragraphs 22.1 and 22.4****(a) Circular No.2-P (LXX-5) of 1963 dated the 15th May, 1963**

Income-tax Act, 1961 - Section 11 - Investment by religious or charitable trusts of capital gains in acquiring another capital asset - Treatment of, as application to religious or charitable purposes and time limit for satisfying the conditions in sub-section (2) of section 11 regarding investment of accumulated income and furnishing of accounts.- "Under section 11(1) of the Income-tax Act, 1961, a religious or charitable trust which accumulates its income in excess of 15% (earlier 25%) of its total income or Rs.10,000, whichever is higher, is liable to pay tax on the income accumulated by it in excess of the said limit. In other words, such a trust has to apply at least 85% (earlier 75%) of its total income, including any capital gains forming part of it, during the relevant previous year in order to be entitled to exemption on the entire amount of its income. In this connection a question was raised during the third meeting of the Direct Taxes Advisory Committee whether the capital gains arising to a trust from the sale of a capital asset belonging to it would be regarded as having been applied for the purposes of the trust, if the trust invested the amount received from the sale of the capital asset including the capital gains realised in acquiring another capital asset for the trust. This point has been considered and it has been decided that where a religious or charitable trust transfers a capital asset forming part of the corpus of its property solely with a view to acquiring another capital asset for the use and benefit of the trust and utilises the capital gains arising from the transaction in acquiring the new capital asset, the amount

of capital gain so utilised should be regarded as having been applied for the religious or charitable purposes of the trust within the meaning of section 11(1).

2. Under sub-section (2) of section 11 of the Income-tax Act, 1961, a trust which desires to accumulate its income in excess of the limit specified in sub-section (1) for subsequent application to the purposes of the trust is entitled to do so on giving a notice to the Income-tax Officer in this behalf in the prescribed form and investing the money so accumulated in certain securities of the Government. Under rule 17 of the Income-tax Rules, 1962, the notice of accumulation is required to be given in Form No.10 of the Income-tax Rules, 1962. According to para 2 of this Form, the accumulated money has to be invested in specified securities before the expiry of one month commencing from the end of the relevant previous year and according to para 3 of the Form, copies of the annual accounts of the trust along with details of investment and utilisation, if any, of the money so accumulated or set apart, have to be furnished to the Income-tax Officer before the 30th April every year. It was pointed out during the third meeting of the Direct Taxes Advisory Committee that it may not always be possible for the trustees to ascertain the income of the trust within one month of the end of the previous year and they may not therefore be able to comply with the requirements referred to above. In respect of the assessment year 1962-63, instructions were issued in the Board's Circular No.17 (LXX-4) of 1962, dated the 2nd June, 1962, that the first requirement should be regarded as having been fulfilled if the accumulated money were invested in the specified securities before the 30th September, 1962, and similarly, the second requirement should be regarded as having been fulfilled if copies of the relevant accounts along with details of investment and utilisation of the accumulated money were furnished to the Income-tax Officer concerned before the 30th September, 1962. Having regard to the difficulty mentioned above, it has now been decided that in respect of

subsequent assessment years, trustees should be allowed to invest the accumulated income in specified securities within an extended period of four months commencing from the end of the relevant previous year. Similarly, with regard to the second requirement of furnishing copies of accounts, etc., it has been decided that trustees may be allowed to do so within a period of four months from the end of the relevant previous year or before 30th April, of the assessment year, whichever is later.

(b) Circular No.12-P (LXX-7) of 1968 dated 26-11-1968

Section 11 - Charitable Trust - Income required to be applied for charitable purposes. - Attention is invited to the Board's Circular No.5-P (LXX-6) of 1968 dated the 19th June, 1968, on the above-mentioned subject.

2. It has been brought to the Board's notice that para 5 of the above circular creates the impression that where a trust accumulates more than 15% (earlier 25%) of its income, only the excess over 15% (earlier 25%) will be taxable under section 11(1) of the Income-tax Act, 1961. It is hereby clarified that the correct position in this regard is 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 15% (earlier 25%) of the income. Further, if the trust does not comply with the conditions laid down in section 11(2), the amount which becomes liable to assessment under section 11(3) is the entire income accumulated and not merely the income accumulated in excess of the limits specified in section 11(1) of the Income-tax Act, 1961. In other words, such an assessee loses the benefit of the accumulation permitted under section 11(1).....”

(c) Circular No.29 dated August 23, 1969

Interpretation of the provisions of sections 11(1) and 11(2) of the Income-tax Act, 1961.- “Attention is invited to the

Board's Circular Nos.5-P (LXX-6) of 1968 and 12-P (LXX-7) of 1968 which had been duly endorsed to all Chambers of Commerce. References are still being received from the public seeking clarifications regarding the taxability of income under the provisions of sections 11(1) and 11(2) of the Income-tax Act, 1961.

2. The legal position is clarified as under:

- (a) Under section 11(1)(a), a trust claiming exemption is allowed to accumulate 15% (earlier 25%) of its income or Rs.10,000, whichever is higher. This, if a trust accumulates a larger income than the limits prescribed for exemption, what would be chargeable to tax is the excess over the exempted limit, and not the entire accumulation including the exempted portion.
- (b) Under section 11(2), however, provides that if the conditions laid down in the sub-section are satisfied, restrictions as regards accumulation or setting apart of income shall not apply for the period during which the conditions prescribed therein remain satisfied. To avoid taxation under section 11(1)(a), investment in Government securities as prescribed in section 11(2) has to be made not only in respect of excess amount which is chargeable under section 11(1)(a) but of the entire unspent balance including the exempted portion.
- (c) Subsequently, if it is found that the provisions of section 12(2) have been violated and the income has been applied to purposes other than charitable or religious or the amount cease to be accumulated or set apart the entire accumulation covered by section 11(2) will be subjected to tax under section 11(3).

3. Thus, while under section 11(1)(a) the tax will be levied in the year to which the income relates, under section 11(3) the income would be chargeable in the year in which the amounts cease to be accumulated for the specific purpose mentioned. Thus, when the amounts are taxed under section 11(3), the benefit which would have been available to a trust in respect of 15% (earlier 25%) of its income or Rs.10,000 under section 11(1)(a) would also be lost.

(d) Circular No. 5-P (LXX-6) of 1968 dated 19th June, 1968

Section 11 - Charitable Trusts - Income required to be applied for charitable purposes- Instructions regarding- "In Board's Circular No. 2-P (LXX-5) of 1963, dated 15th May, 1963, it was explained that a religious or charitable trust claiming exemption under section 11(1) of the Income-tax Act, 1961, must spend at least 85% (earlier 75%) of its total income for religious or charitable purposes. In other words, it was not permitted to accumulate more than 15% (earlier 25%) of its total income. The question has been reconsidered by the Board and the correct legal position is explained below.

Section 11(1) provides that subject to the provisions of sections 60 to 63 'the following income shall not be included in the total income of the previous year.....'. The reference in sub-section (a) is invariably to 'income' and not to 'total income'. The expression 'total income' has been specifically defined in section 2(45) of the Act as 'the total amount of income Computed in the manner laid down in this Act'. It would accordingly be incorrect to assign to the word 'income' used in section (11)(1)(a), the same meaning as has been specifically assigned to the expression 'total income' vide section 2(45).

In the case of a business undertaking held under trust, its 'income' will be the income as shown in the accounts of the undertaking. Under section 11(4), any income of the

business undertaking determined by the I.T.O. in accordance with the provisions of the Act, which is in excess of the income as shown in its accounts, is to be deemed to have been applied to purposes other than charitable or religious, and hence it will be charged to tax under sub-section (3). As only the income disclosed by the account will be eligible for exemption under section 11(1), the permitted accumulation of 15% (earlier 25%) will also be calculated with reference to this income.

Where the trust derives income from house property, interest on securities, capital gains, or other sources, the word 'income' should be understood in its commercial sense, i.e., book income, after adding back any appropriations or applications thereof towards the purposes of the trust or otherwise, and also after adding back any debits made for capital expenditure incurred for the purposes of the trust or otherwise. It should be noted, in this connection, that the amounts so added back will become chargeable to tax under section 11(3) to the extent that they represent outgoings for purposes other than those of the trust. The amounts spent or applied for the purposes of the trust from out of the income computed in the aforesaid manner, should be not less than 85% (earlier 75%) of the latter, if the trust is to get the full benefit of the exemption under section 11(1).

To sum up, the business income of the trust as disclosed by the accounts plus its other income computed as above, will be the 'income' of the trust for purposes of section 11(1). Further, the trust must spend at least 85% (earlier 75%) of this income and not accumulate more than 15% (earlier 25%) thereof. The excess accumulation, if any, will become taxable under section 11(1)."

2. Circular relating to paragraph no. 30

Circular No.143 [F. No.180/74/73-IT(A1)] dated 20.8.1974

Requirement of filing audit report by charitable and religious trusts - section 12A(b)

1. Under section 12A(b) of the Income-tax Act, 1961 in the case of charitable and religious trusts or institutions whose total income without giving effect to the provisions of sections 11 and 12 of the Income-tax Act, 1961, exceeds 25,000 rupees in any previous year, the accounts of the trust or institution should have been audited by an accountant as defined in the Explanation below section 288(2) and the person in receipt of the income should furnish along with the return of income for the relevant assessment year the report of such audit in the prescribed form duly signed and verified by such authority and setting forth such particulars as may be prescribed. Rule 17B of the Income-tax Rules, 1962 lays down that the report of audit of accounts of the trust or the institution should be in Form 10B. The annexure to the Form 10B requires the auditor to certify, *inter alia*, as to the non-application or non-user of the income or property for the benefit of persons referred to in section 12(3).

2. The Board have considered a representation that while filing the Form 10B and its annexure, as auditor can accept as correct the list of persons covered by section 13(3) as given by the managing trustees, etc. The Board agrees that, till further instructions, an auditor can accept as correct the list of specified persons given by the managing trustees and base the report on the strength of this certificate.

3. Circular relating to paragraph No. 26.3(d)

Circular No.100 dated 24th January, 1978 (F.No.195/1/72-IT(A1))

44/S. 11. Repayment of a debt incurred for charitable purposes by a charitable trust and loans advanced by educational trust-Application of income.

Section 11 of the Income-tax Act requires 100% of the income of a charitable and religious trust to be applied for religious and charitable purposes to be entitled to the exemption under the said section. Two questions have been considered the application of income:

- (i) Where a trust incurs a debt for the purposes of the trust, whether the repayment of the debt would amount to an application of the income for the purposes of the trust; and
- (ii) Whether loans advanced by an educational trust to students for higher studies would be treated as application of income for charitable purposes.

2. Board has decided that repayment of the loan originally taken to fulfil one of the objects of the trust will amount to an application of the income for charitable and religious purposes. As regards the loan advanced for higher studies, if the only object of the trust is to give interest-bearing loans for higher studies, it will amount to carrying on of money-lending business. If, however, the object of the trust is advancement of education and granting of scholarship loans as only one of the activities carried on for the fulfillment of the objectives of the trust, granting of loans even interest-bearing will amount to the application of income for charitable purposes. As and when the loan is returned to the trust, it will be treated as income of that year.

ANNEXURE – VI**Debatable issues****(See paragraph No.42.1)**

1. *Commissioner cannot refuse registration on the ground that the bye-laws of the society had not been changed so as to exclude religious aspect, At the stage of grant of certificate under section 12A, the only enquiry which could possibly be made would be whether the society has actually made an application in time and whether the accounts of the society are maintained in the manner as suggested by the said section. Beyond that the scope of enquiry would not go- New Life in Christ Evangelistic Association (NLC) v. CIT (2000) 111 Taxman 16 (Mad).*
2. *At the time of registration, the Commissioner is not required to verify about the application of income on the objects of the trust. Commissioner only has only to see whether the objects of the trust are charitable or not - Fifth Generation Education Society v. CIT, 185 ITR 634 (All).*
3. *After allowing registration under section 12A(a), it is beyond the powers of the Assessing Officer to reject the claim of exemption under section 11 by looking into the objects of the association and holding the same to be non-charitable in nature - Stock Exchange, Ahmedabad, v. ACIT, 74 ITD 1 (Ahd).*
4. *If depreciation is not allowed as a necessary deduction for computing the income of a charitable institution, then there can be no way to preserve the corpus of the trust for deriving the income. Therefore, the amount of depreciation debited to the accounts of a charitable institution is to be deducted to arrive at the income available for application to charitable and religious purposes - CIT v. Society of The Sisters of St. Anne, 146 ITR 28 (Kar.); CIT v. Raipur Pallottine Society, 180 ITR 579 (MP); CIT v. Sheth Manilal Ranchhoddas Vishram*

Bhavan Trust, 198 ITR 598 (Guj), IAC v. Mahila Sidh Nirman Yojna, 50 TTJ 494 (Delhi Trib).

5. *Merely because the cost of acquisition of an asset has been claimed as an application of income for charitable purposes in the year of acquisition, a charitable trust cannot be denied depreciation in respect of such asset - DIT(E) v. Framjee Cawasjee Institute 109 CTR (Bom) 463.*
6. *Applying commercial principles, income tax and wealth tax paid are to be excluded in computing the income of a charitable or religious trust - CIT v. Nizam's Supplemental Religious Endowment Trust, 127 ITR 378 (AP); CIT v. Ganga Charity Trust Fund, 162 ITR 612 (Guj); CIT v. Janaki Ammal Ayya Nadar Trust, 153 ITR 159 (Mad); CIT v. Baroda Industrial Development Corporation, 198 ITR 716 (Guj).*
7. *Repayment of loan scholarship can never constitute income of a trust, even if it has claimed deduction of such loan scholarships as an application for charitable purposes - CIT v. Trustees of Kasturbai Scindia Commission Trust, 189 ITR 5 (Bom).*
8. *In the case of a trust or institution income from business would be eligible for exemption if the following two conditions are fulfilled –*
 - (a) *the business carried on should be incidental to the attainment of the objects of the trust/institution; and*
 - (b) *separate books of accounts should be maintained in respect of such business.*

The above-mentioned requirement has come into existence with effect from A.Y. 1992-93. Earlier the exemption for business income was available if it was the primary purpose of the Trust or where the business was carried on by the beneficiaries or it was business of printing and publication of books. In view of the change in law, the profits earned from newspaper business is eligible for exemption if such profits are used for the objects of the Trust – CIT v. Thanthi Trust, 247 ITR 785 (SC).

9. *Purchase of assets for the purpose of carrying out the objects of the trust amounts to application of income within the meaning of the provisions of section 11(1)(a)- M.Ct.M. Tiruppani Trust, 230 ITR 636 (SC); Kannika Parmeswari Devasthanam & Charities, 133 ITR 779, (Mad).*
10. *Amount spent on construction of building for the purpose of getting some rent, which income would be applied for charitable or religious purposes, amounted to application of income for charitable or religious purposes- CIT v. St. George Forana Church, 170 ITR 62 (Ker).*
11. *Administrative expenses can be considered as expenses on the objects of the trust unless they can be directly attributable to earning such income. Miscellaneous expense for carrying on object must be considered as application for charitable purpose - Parsi Zoroastrian Anjuman Trust v. CIT, 34 Taxman 82 (MP); CIT v. Birla Janahit Trust, 73 Taxman 465 (Cal); Gem and Jewellery Export Promotion Council v. ITO, 68 ITD 95 (Bom).*
12. *Trust had taxable income and exempt income (subscription). Held that expenses on object of the trust and on investments cannot be apportioned pro rata between income from property and investment and from subscription income. Expenses to be deducted from taxable income - Silk and Art Silk Mills Association Ltd. 182 ITR 38 (Bom). The insertion of Sec.14A will have no implication on chapter III as it applies to computation of total income under chapter IV only.*
13. *If trust incurs expenses out of corpus of the trust and seeks to reimburse said amount out of the income of subsequent year, the trust would be entitled to claim exemption in respect of such reimbursement - CIT v. Shri Plot Swetamber Murti Pujak Jain Mandal, 211 ITR 293 (Guj); CIT v. Maharana of Mewar Charitable Foundation, 164 ITR 439 (Raj); CIT v. Matriseva Trust, 242 ITR 20 (Mad); Gem and Jewellery Export Promotion Council Vs. ITO, 68 ITO, 68 ITD 95 (Bom).*

14. *A charitable trust is expected to make an application for accumulation of income along with the return of income. Even if the application is filed along with a return furnished under section 139(4), the same should be treated as filed in time. Even otherwise, delay could be condoned in view of the powers delegated by the Board under section 119(2)(b) vide CBDT circular no.180/57/80-IT(AI) dated 3rd June, 1980 (120 ITR 28 St). Delay in filing the application is not fatal – CIT v. Ziarat Mir Syed Ali Hamdani, 248 ITR 769 (J&K); Tulsidas Gopalji Charitable and Chaleshwar Temple Trust v. CIT, 207 ITR 368 (Bom). This principle has been confirmed by the Bombay High Court in the case of Director of Income-tax (Exemptions) v. Sheth Mafatlal Gagalbhai Foundation Trust and others 249 ITR - 533. However, furnishing of Form 10 after the completion of assessment cannot be accepted – CIT v. Nagpur Hotel Owners' Association, 247 ITR 201 (SC).*
15. *Only income from unapproved investment shall be taxable at the maximum marginal rate, whereas for the rest of the income, exemption will not be denied - Gurdayal Berlia Charitable Trust, 34 ITD 489 (Bom Trib).*
16. *Registered educational society was formed for the sole purpose of establishing, running or assisting schools and colleges. It was held that it would be unreal and hypertechnical to hold that the assessee society was only financing body and would not come within the scope of "Other educational institute". Merely because a surplus results incidentally from the activity lawfully carried out by the educational institution, it will not cease to be one existing solely for educational purposes, since the object is not to make profit - Aditanar Educational Institution v. Addl. CIT, 224 ITR 310 (SC).*
17. *Status of a public charitable trust is "Individual", and it is therefore entitled to deduction under section 80L- ADIT(E) v. Freny Savakshah Anjirbaug & Siyavaksh Rustomji Anjirbaug Charitable Trust, 60 TTJ (Mum) 91, Auroboutique Trust v. ITO, 36 TTJ (Mad) 318. Secion 164 does not determine*

status of the trust. Trustee is an individual and hence trust entitled to section 80L deduction - CIT v. Ramesh Sanjay Trust, 231 ITR 752 (Mad). The Bombay High Court has confirmed this view in the case of Director of Income-tax (Exemptions) Vs. Shardaben Bhagubhai Mafatlal Public Charitable Trust and others. 247 ITR 1.

- 18.** *Adjustment of Excess of expenditure in earlier year against income of subsequent year: It is possible for a charitable trust to adjust the expenditure incurred in an earlier year against the subsequent year's income and treat it as application of income for the objects of the Trust. Refer to Govindu Nayakar Estate v. ADIT, 248 ITR 368 (Mad); CIT v. Matriseva Trust, 242 ITR 20 (Mad); CIT v. Maharana of Mewar Charitable Foundation, 164 ITR 439 (Raj); CIT v. Shri Plot Wetamber Murti Pujak Jain Mandal; 211 ITR 293 (Guj). However, it is possible to take a view that such a claim may not be valid unless there is a deficit in the Income and Expenditure account as shown in the opening Balance Sheet. In other words, in order to sustain a claim that income of a year adjusted against the deficit of an earlier year should be treated as applicable, the deficit of the earlier year should not only have been in the Income and Expenditure Account of that year but should also be carried forward in the Balance Sheet.*
- 19.** *15% of the income which automatically qualifies for exemption has to be worked out on the gross income before reducing the amounts applied for charitable purposes during the year - CBDT circular dated 19.06.1968; CIT v. Programme for Community Organisation 2001, 248 ITR 1 (SC).*
- 20.** *It is mandatory for an Educational Institution to furnish return of income every year in order to qualify for exemption under section 10(23C). If there is default penalty can be levied for non-filing of return - Director of Income-tax (Exemption) v. Malad Jain Yuvak Medical Relief Centre, 250 ITR 488 (Bom) / 168 CTR 484 (Bom).*

21. *In the case of an Educational Institution, the exemption is confined not only to the income generated from the running of the Institution but also to other income earned and applied for the objects subject to satisfaction of the other conditions - CIT v. A.M.M. Arunachalam Educational Society, 243 ITR 229 (Mad).*
22. *Even when the whole of the capital expenditure may be treated as an application of income towards charitable or religious purposes for the purposes of section 11, the trust may also claim depreciation in respect of the assets used by it for its purposes on the basis of normal commercial principles following the Circular No.5-P (LXX-6) of 1968 dated 19th June, 1968 issued by the CBDT. The Hon'ble Supreme Court in Escorts Ltd. 199 ITR 43 held that a double deduction in regard to the same outgoing cannot be allowed. Although it can be argued that section 11 does not refer to deduction but to exclusion of income, the issue still appears to be debatable.*
23. *Charitable trust - Requirement of filing audit report in Form No.10B - Section 12A(b)-Instructions regarding, - The Board have considered whether the requirement under section 12A(b) of filing audit report 'along with the return of income' is mandatory so as to disentitle the trust from claiming exemption under sections 11 and 12 in case of omission to furnish such report in the prescribed form along with the return.*
24. *Normally, it should be possible for a charitable or religious trust or institution to file the auditor's report along with the return of total income where such trust or institution claims exemption under sections 11 and 12. However, in cases where for reasons beyond the control of the assessee some delay has occurred in filing the said report the exemption as available to such trust under sections 11 and 12 may not be denied merely on account of delay in furnishing the auditor's report and the Income-tax Officer should record reasons for accepting a belated audit report. [Board's F. No.267/482/77-*

IT (Part), dated February 9, 1978 - CBDT Bulletin Tech XXIII/582 : (1992) 195 ITR 825, 833 (Cal).]

Where the audit report was filed along with a properly filed revised return, there is no contravention of section 12A(b) even though such audit report was not filed along with the original return [CIT v. Sri Baldeoji Maharaj Trust, (1983) 142 ITR 584 (All)].

The requirement of furnishing an audit report 'along with the return', as contained in section 12A(b), is not a mandatory condition but is a directory one. In that view of the matter, a trust is entitled to exemption under section 11 even though the audit report is filed before the completion of the assessment for the relevant assessment year [CIT v. Rai Bahadur Bissesswarlal Motilal Halwasia Trust, (1992) 195 ITR 825, 832 (Cal)]. This is so because, if the audit report is not filed along with the return, the return becomes defective and the Assessing Officer should give an opportunity to the assessee to submit the audit report to rectify the defect before completion of the assessment. Where an assessee, in compliance with the provisions of the Act, cures the defect in the return by filing the audit report before the completion of the assessment, the Assessing Officer cannot ignore such audit report or the return in completing the assessment [CIT v. Rai Bahadur Bissesswarlal Motilal Halwasia Trust, (1992) 195 ITR 825, 832 (Cal)]. In this view of the matter and in view of the fact that the scope of the power of the appellate authority is co-terminous and co-extensive with that of the Assessing Officer, the Tribunal was held justified in law in setting aside the orders of the first appellate authority and the Assessing Officer and in directing the Assessing Officer to accept the auditor's report in Form No.10B and to process the assessee's claim for exemption under section 11 afresh [CIT v. Hardeodas Agarwalla Trust, (1992) 198 ITR 511, 519, 520 (Cal)].

The Board by issuing the circular dated 9-2-1978 has treated the provisions regarding furnishing of the auditor's report

along with the return to be procedural and, therefore, directory in nature. By showing sufficient cause, the auditor's report could be produced at any stage either before the Assessing Officer or before the appellate authority. In that view of the matter, the Tribunal has been held right in law in setting aside the order of the first appellate authority in regard to filing of the audit report in terms of the provisions of section 12A(b) and in directing that authority to allow the assessee to submit the said audit report to it at the appellate stage [CIT v. Shahzedanand Charity Trust, (1997) 228 ITR 292, 299 (Punj)].

In CIT v. Devradhan Madhavlal Genda Trust [(1998) 230 ITR 714, 717 (MP)], the Tribunal was held justified in holding that the filing of the audit report in Form No.10B with the return of income was not mandatory and it was sufficient compliance of section 12A(b) if the same was filed during the course of the assessment proceedings.

- 25.** *Investment in a fixed deposit with a public sector company or scheduled bank account is acquisition of new asset-CIT v. East India Charitable Trust (1994) 206 ITR 152/73 Taxman 380 (Cal), DIT (Exemp) in DLF Qutub Enclave Complex Medical Charitable Trust (2001) 115 Taxmann 520 (Del.).*

For the purpose of section 11 (1A) , so long as investments are actually made in units of UTI during accounting , issue of units after expiry of accounting year is immaterial - CIT v. East India Charitable Trust (1994) 206 ITR 152/73, Taxmann 380 (Cal).

- 26.** *Excess application of last year- Account of excess application of the last year can be set off against the deficiency of the subsequent assessment year- CIT v. Matriseva Trust (2000) 242 ITR 20 Mad.*
- 27.** *Revenue or Capital Purposes. Application of the account can be for revenue or capital purpose. So long as the expenditure is incurred out of the income earned by the trust, even if such expenditure is for capital purpose, on the object of the trust,*

the income would be exempt - CIT v. Kanika Prameswari Devasathanam and Charties (1982) 133 I.T.R 779 (Mad)

- 28.** *Applied vs Expenditure. The word applied is wider in import than the word expenditure. The sum spent on the construction of additions to the buildings owned by a religious institution, which were let out, and income therefrom was used for religious purposes, can be said to be an application of the income for religious or charitable purpose- CIT v. St George Forane Church (1987) Tax LR 1304 (Ker)*

It is not correct to equate the word "applied" as used in section 11 with the word spent. For instance, if the charitable trust debits its accounts as soon as it passes resolutions sanctioning donations to various donees, and such amounts, as are outstanding, are shown as liabilities in the balance sheet. The amounts which are sanctioned but not actually spent in the relevant accounting year will constitute application of funds for charitable purpose, within the meaning of section 11(1)(a)- CIT v. Trustee of HEH , The Nizam's Charitable Trust (1981) 131 ITR 497 (AP.).

When a donor trust which is itself a charitable and religious trust donates its income to other trust, the provision of section 11(1)(a) can be said to have been met by such donor trust and the donor trust can be said to have applied its income for religious and charitable purpose. Utilisation by the donee trust in any year would not be relevant for the purpose of deciding whether the donor trust can get exemption under section 11 or not – CIT v. Sarladevi Sarabhai Trust (2) 1988 172 ITR 698, (Guj.), CIT v. Thanthi Trust (1999) 239 ITR 502 (SC), CIT vs Nirmala Bakubhai Foundation (1997) 226 ITR 394 (Guj).

ANNEXURE - VII

(See paragraph 6.6)

List of allied legislations**A. Trust legislations**

- (i) Indian Trusts Act, 1882
- (ii) The Societies Registration Act, 1860
- (iii) The Companies Act, 1956 (Section 25)
- (iv) Bombay Public Trusts Act, 1950
- (v) Rajasthan Public Trusts Act, 1959
- (vi) Madhya Pradesh Public Trusts Act, 1951

B. State Laws for registration of societies

- (i) Andhra Pradesh Societies Registration Act, 2001
- (ii) Madhya Pradesh Societies Registration Act, 1973
- (iii) Tamil Nadu Societies Registration Act, 1975
- (iv) Karnataka Societies Registration Act, 1960
- (v) The West Bengal Societies Registration Act, 1961
- (vi) Manipur Societies Registration Act of 1989
- (vii) The Societies Registration (Nagaland) First Amendment Act, 1969
- (viii) The Travancore Cochin Literary Scientific and Charitable Societies Registration Act, 1955 (Kerala)
- (ix) The Societies Registration Act 1860, (Punjab Amendment Act, 1957)
- (x). Meghalaya Societies Registration Act, 1983
- (xi) Rajasthan Societies Registration Act of 1958
- (xii) Himachal Pradesh Societies Registration Act, 2006

C. Trusts under religious Acts

- (i) The Wakf Act, 1995
- (ii) The Delhi Sikh Gurudwara Act, 1971
- (iii) Madras Hindu Religious and Charitable Endowments Act, 1951
- (iv) Andhra Pradesh charitable and Hindu Religious Institution and Endowment Act, 1966
- (v) Travancore-Cochin Hindu Religious Institutions
- (vi) Karnataka Hindu Religious Institutions and Charitable Endowments Act, 1997

D. Other Acts

- (i) Charitable Endowments Act, 1890
- (ii) Charitable and Religious Trust Act, 1920
- (iii) The Foreign Contribution (Regulation) Act, 1976 (FCRA).