

Union Budget 2022 – Key amendments proposed for charitable organisations

Background

The Finance Bill, 2022 has proposed a number of amendments in the Income-tax Act, 1961 related to the taxation of charitable trusts/institutions.

Broadly, most of the charitable trusts/institutions fall under the following two regimes:



Trusts or institutions registered under section 12AB (charitable trusts' regime)



Funds, trusts, institutions, universities/other educational institutions, or hospitals/other medical institutions approved under section 10(23C) (specified institutions' regime)

Historically, the charitable trusts' regime contained detailed provisions regarding taxation and the administrative/procedural framework as compared with the specified institutions' regime. As a part of the government's desire to bring in consistency

between the above two regimes, several amendments to the Income-tax Act have been proposed to be carried out by the Finance Bill, 2022.

Snapshot of the proposed key changes

A. Changes to the taxation framework

I. Period of utilisation of accumulation

A trust/institution is required to apply at least 85 percent of its income towards charitable activities in a particular year. However, in the event this threshold is not met, the law allows for the accumulation of funds to be applied for charitable purposes in the future years (not exceeding 5 years), subject to certain conditions. Currently, such accumulated funds can be applied even in the year subsequent to the previous year of accumulation—if it is not used in such subsequent year as well, then the funds not applied become taxable in such subsequent year.

Now, it is proposed to do away with the option of allowing application in such subsequent year—therefore, if the accumulated funds are not entirely applied up to the previous year of accumulation, then the funds not applied become taxable in such last year.

This change is proposed to be effective from FY22–23.

II. Application of income to be reckoned only on 'payment' basis

Currently, there is no explicit provision determining the manner of reckoning the application of income (i.e., on accrual basis in case of trusts/institutions following the mercantile system of accounting or on payment basis).

Now, it is proposed that the application of income shall be reckoned only on 'payment' basis.

This change is proposed to be effective from the current year, i.e., FY2021–22 itself. **Therefore, the trusts/institutions may ensure that expenses pertaining to/accrued in the current year be paid latest by 31 March 2022 for such expense to be treated as application of income in the current year.**



III. Computation of taxable income resulting on account of certain prescribed non-compliances

Currently, there is no explicit provision determining the manner of computation of taxable income resulting on account of non-compliances.

Now, it is proposed to that the taxable income resulting on account of prescribed non-compliances (such as not maintaining prescribed books of accounts, not filing the Return of Income, and carrying on commercial activities for consideration beyond the prescribed threshold) shall be computed after allowing deduction of revenue expenditure incurred in India, but subject to the following conditions:

- Expenditure should not be a donation or contribution to any person.
- Expenditure incurred without withholding appropriate tax or expenditure incurred in cash beyond the prescribed threshold shall not be allowed.
- Expenditure incurred from the corpus or any loan or borrowing shall not be allowed.
- Depreciation on an asset, the cost of which is claimed as application of income in any year, shall not be allowed.

This change is proposed to be effective from FY22–23.

IV. New tax rate prescribed for specified incomes

Currently, there is an ambiguity on the tax rate that applies, where certain specified incomes of the trust/institution become taxable.

Now, it is proposed that specified incomes (resulting from violations such as accumulation of funds for prohibited purposes, partial application of accumulated funds, deployment of funds in prohibited investments, and diversion of income/provision of excessive benefits to trustees/other specified persons) would be taxable at a flat rate of 30 percent (plus applicable surcharge if any and cess) without reduction of any expenditure or allowances or set off of losses. Other incomes (if any) of the trust/institution will be taxable per the currently applicable provisions.


This change is proposed to be effective from FY22–23.

V. Proportionate income (instead of entire income) now made taxable on account of prescribed non-compliance

It is proposed that if trust/institution diverts income/provides excessive benefits to trustees/other specified persons or deploys its funds in prohibited investments only that part of income that is diverted/regarded as

excessive benefit/deployed in prohibited investments would be taxable. This position has been upheld in certain rulings even before the amendment. As discussed above, such incomes will be taxable at a flat rate of 30 percent without any deductions.


This change is proposed to be effective from FY22–23.

 **This is a welcome change where small violations are not taxed disproportionately**

VI. Penalty for diversion of income/provision of excessive benefits to trustees/other specified persons

A trust/institution will be liable to penalty for diversion of income/provision of excessive benefits to trustees/ other specified persons. The penalty will be equal to 100 percent of the amount diverted in case of the first instance and will go up to 200 percent of the amount diverted in case of violations in subsequent years. This penalty will be in addition to any other penalties that may be levied under the existing law.

This change is proposed to be effective from FY22–23.

 **Trustees will need to be mindful of the new penal consequences on diversion of income to trustees**


B. Streamlining of the administrative/procedural framework

I. Maintenance of the prescribed books of accounts

Where the total income of the trust/institution exceeds the basic exemption limit, it is required to get its books of accounts audited. Currently, there are no specific books of accounts that the trust/institution is required to maintain.

Now, it is proposed that such a trust/institution would be required to maintain the prescribed books of accounts.


This change is proposed to be effective from FY22–23.

 **This is a step towards better governance of trusts**

II. Withdrawal of registration/approval provisions revamped

The provisions dealing with withdrawal of the registration/approval of a trust/institution have been revamped. Notably, the new provisions enumerate certain ‘specified violations’ that will lead to a withdrawal of the registration/approval—amongst them is having a business that is not incidental to the attainment of its objectives, material non-compliances in other legislations, etc.

This change is proposed to be effective from FY22–23.

 **Trusts owning non-incident business may have to explore divesture or restructure of such businesses**

C. Bringing in consistency in the specified institutions’ regime

I. A trust/institution is required to apply at least 85 percent of its income towards charitable activities in a particular year. However, in the event this threshold is not met, the law allows for accumulation of funds to be applied for charitable purposes in the future years (not exceeding 5 years). Such accumulation is subject to certain conditions in respect of trusts/institutions governed under the charitable trusts’ regime.

Now, such conditions are proposed to be made applicable in respect of trusts/institutions governed under the specified institutions’ regime as well.

II. Currently, under the charitable trusts’ regime, income diverted/excessive benefits provided to trustees/other specified persons result in such amount becoming taxable for the trust/institution.

Now, such provision is proposed to be made applicable under the specified institutions’ regime as well.

III. Currently, under the charitable trusts’ regime, there is a requirement to file a Return of Income for claiming exemption.

Now, such requirement for claiming exemption is proposed to be made applicable under the specified institutions’ regime as well.

IV. Currently, re-organisation (i.e., conversion, merger or transfer of assets on dissolution) of trusts/institutions governed by the charitable trusts' regime with any non-qualifying entity (i.e., an entity that is not governed by either of the regimes applicable to charitable trusts/institutions) triggers a taxation under the accreted income provisions.

Now, the accreted income provisions are proposed to be made applicable to trusts/institutions governed by the specified institutions' regime as well.

These changes are proposed to be effective from FY22–23.



Exemption under the specified institutions' regime from accreted income taxation available only till 31 March 2022 – institutions contemplating such reorganization may have to explore the implications



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