

# EY Tax Alert

**CBDT clarifies on income tax implications of inter-trust donations by one registered charitable entity to another**

## Executive summary

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This Tax Alert summarizes a recent Circular<sup>1</sup> issued by the Central Board of Direct Taxes (CBDT)<sup>2</sup> wherein the CBDT clarifies the tax treatment of non-corporus donations made by one registered charitable entity<sup>3</sup> to another in the wake of amendment by Finance Act (FA) 2023, which restricted the eligible application of such donated amount to 85% leaving 15% as ineligible application in computing the income of the trust under the Income Tax Laws (ITL) (15% amount is hereinafter referred as Ineligible Application). The CBDT clarifies that Ineligible Application will not trigger any adverse consequences in the hands of donor charitable entity since such income is spent by way of inter-trust donation and has relaxed the requirement of making investment in prescribed modes with respect to such Ineligible Application in absence of any funds. By way of the illustration given in the Circular, the CBDT further clarifies that the charitable entity can avail full exemption under the ITL if 85% of the balance income (i.e., gross income as reduced by inter-trust donation) is applied for charitable purposes in accordance with the provisions of the ITL.

<sup>1</sup> CBDT Circular No. 3/2024 dated 6 March 2024

<sup>2</sup> Apex body for administration of direct taxes in India

<sup>3</sup> Charitable entity registered under section (s.) 12AB or s. 10(23C) of Income Tax Act, 1961 (ITL)

## Background

- ▶ Income of a registered charitable entity is exempt from income tax under the ITL subject to fulfilment of conditions specified therein (hereinafter referred to as charitable entity). Amongst others, one of the conditions for availing exemption is that at least 85% of current year's income is applied or accumulated<sup>4</sup> for charitable purpose. Once 85% of current year's income is applied or accumulated, the entire 100% income of such charitable entity is exempt from income-tax under the ITL.
- ▶ Accordingly, the ITL allows charitable entity to accumulate 15% of its current year's income without any spending condition (15% permissible accumulations). However, the charitable entity is always subject to an overarching condition to keep its entire unutilized funds (including 15% permissible accumulations) deposited or invested in specified modes<sup>5</sup> as prescribed under the ITL until its utilization on its objects.
- ▶ Also, charitable entity is allowed to apply its income directly or by way of non-corpus regular donation to other charitable entities having similar objects. However, vide FA 2023, regular donation made by charitable entity to another was reckoned for application only to the extent of 85% in the hands of donor charitable entity. The balance 15% amount of inter-trust donation is referred herein as 'Ineligible Application'.

The intention of the amendment was to discourage chain donations amongst different charitable entities each claiming the benefit of 15% permissible accumulation resulting in no effective spending on charitable purposes.

- ▶ The FA 2023 amendment gave rise to an interpretational issue as to whether Ineligible Application will result in taxation thereof or is protected under 15% permissible accumulation criteria. It also raises the challenge on meeting with an obligation to keep deposited 15% permissible accumulation in specified investments in absence of any funds since those funds of the charitable entity were donated, and nothing was left with the donor entity.
- ▶ Considering that the amendment had widespread consequences affecting most of the charitable entities including Corporate Social Responsibility Trusts, various representations were made by stakeholders seeking clarity.
- ▶ In the wake of the above concerns, the CBDT has now clarified the position vide the CBDT Circular.

<sup>4</sup> Accumulation of income is permitted subject to satisfaction of specified conditions.

## CBDT Circular

- ▶ The CBDT Circular reiterates that eligible donations made by one charitable entity to another shall be treated as valid application for charitable purpose only to the extent of 85% of such donations.
- ▶ Further, it clarifies that amount of Ineligible Application is not required to be deposited in specified modes of investment as the said entire income thereof is donated to other charitable entity.
- ▶ CBDT Circular explains the above relaxation by way of a numerical illustrations wherein charitable entity makes chain donations to other charitable entities by either donating part of the income or its entire income. In both these scenarios, the charitable entity is eligible for exemption under the ITL in respect of whole of the amount donated even after considering Ineligible Application where either entire income is spent or 85% of income other than utilized for inter-trust donation, is applied.

<sup>5</sup> S. 11(5) of the ITL

**Comments:**

- ▶ The Circular issued for clarifying scope of Ineligible Application on inter-trust donations is a welcome move. This provides much needed certainty to the donor charitable entity. Amongst others, beneficiary of this clarification will be various Corporate Social Responsibility Trusts as they generally operate under funding entity model for various small grassroots charitable entities operating in various parts of the country.
- ▶ The underlying principle of CBDT Circular appears to permit benefit of 15% permissible accumulation to inter-trust donation as standard deduction. Accordingly, the charitable entity may be allowed to avail full exemption under the ITL if the balance income (i.e., gross income as reduced by inter-trust donation) is applied for charitable purposes in accordance with the provisions of ITL. This is explained by way of the following two illustrations as follows:

**Illustration 1:**

Particulars		Prior to FA 2023 Amendment	Post FA 2023 amendment read with CBDT Circular
Income of the trust	A	300	300
Less: Inter-trust donations	B	(100)	(100) <sup>6</sup>
<b>Balance funds available for direct application</b>	<b>C = A - B</b>	<b>200</b>	<b>200</b>
15% permissible accumulation	D	45 (15% of A)	30 (15% of C)
<b>Amount to be applied for complete exemption</b>	<b>E = C - D</b>	<b>155</b>	<b>170</b>
Amount actually applied for charitable purposes	F	155	170
<b>Chargeable income</b>	<b>G = E - F</b>	<b>Nil</b>	<b>Nil</b>
<b>Liquidity available with trust for future application (invested in permissible modes)</b>	<b>H</b>	<b>45</b>	<b>30</b>

**Illustration 2:**

Particulars		Prior to FA 2023 Amendment	Post FA 2023 amendment read with CBDT Circular
Income of the trust	A	300	300
Less: Inter-trust donations	B	(100)	(100) <sup>7</sup>
<b>Balance funds available for direct application</b>	<b>C = A - B</b>	<b>200</b>	<b>200</b>
15% permissible accumulation	D	45 (15% of A)	30 (15% of D)
<b>Amount to be applied for complete exemption</b>	<b>E = C - D</b>	<b>155</b>	<b>170</b>
Amount actually applied for charitable purposes	F	100	100
<b>Chargeable income<sup>8</sup></b>	<b>G = E - F</b>	<b>55</b>	<b>70</b>
<b>Liquidity available with trust for future application (invested in permissible modes)</b>	<b>H</b>	<b>45</b>	<b>30</b>

The above illustrations indicate that post amendment, the quantum of application necessary to avail same level of tax exemption is enhanced when application includes inter-trust donations. To that extent as illustrated above, permissible accumulations for future period gets restricted to 15% of the residual amount i.e., gross receipts net of inter-trust donations.

- ▶ The Circular is benevolent and hence is binding on the tax authority. As per recent trend of Government, generally, benevolent circulars are codified with subsequent amendment in the law. Suitable policy advocacy may be explored by stakeholders to seek specific amendment in ITL to align with the clarification issued in the CBDT Circular.

<sup>6</sup> Only 85% of inter-trust donation is allowed as valid application.

<sup>7</sup> Only 85% of inter-trust donation is allowed as valid application.

<sup>8</sup> Subject to availing benefit of further accumulation for spending over a period of five years under s. 11(2) of the ITL.

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