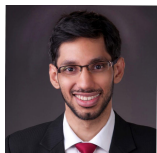


Corpus Donation of Shares - Tax Analysis!

Dec 05, 2022



Suril Mehta

Director, Transaction Advisory, K.C. Mehta & Co. LLP



Nimit Mehta

Senior Manager, Transaction Advisory, K.C. Mehta & Co. LLP



Yog Bakshi

Assistant Manager, Transaction Advisory, K.C. Mehta & Co. LLP

I. Introduction

The Finance Act, 2021 introduced a plethora of amendments in the Income-tax Act, 1961 (the Act), especially in the provisions pertaining to taxation of a charitable trust. One such amendment was introduced in Section-11(1)(d) of the Act.

Prior to such an amendment, income in the form of corpus donations enjoyed a blanket exemption without any conditions attached. Now, the amendment introduced by Finance Act 2021 requires charitable trusts to invest/deposit such donation in one or more of the modes specified u/s 11(5) maintained specifically for the corpus.

Although this change seems insignificant, it has remarkable practical repercussions. For instance, consider the following case scenario-

Mr. X seeks to gift the shares of ABC Ltd. (an unlisted, non-government company) to a charitable trust (the Trust) with specific directions that the shares received as gift and any amount received on liquidation of such shares, would form part of the corpus of the Trust. Thereafter, the Trust would sell the shares and receive consideration on such transfer. The Trust desires to invest the funds received in a Fixed Deposit with a Scheduled Bank^[1].

The above scenario leads to a fundamental question: *whether corpus donation in the form of shares of a company shall be eligible for exemption under section 11 of the Act, considering the recent amendment which requires that the voluntary contribution should be deposited in mode specified under section*

11(5)?

II. Whether corpus donation to a charitable trust in the form of equity shares shall be eligible for exemption under section 11?

Corpus Donation in kind:

Section 11 of the Act provides for the conditions and the manner in which the taxable income of a charitable trust can be claimed as exempt by such trusts. On a perusal of the provisions of Section 11, one might inquire as to whether corpus donation of a non-monetary item (like equity shares) is eligible for the exemption u/s 11 of the Act?

We begin our analysis from the provisions of section 11(1)(d), which deals with tax treatment of corpus donations in the hands of trust. Section 11(1)(d) contains no specific reference to donation, being in the form of a “sum of money” or “any sums paid/received” and therefore it can be said that the concept of ‘in-kind corpus donations’ has been envisaged by the legislature while drafting the said provision.

The Hon’ble Supreme Court in the case of *H.H. Sri Rama Verma v. CIT* [\[TS-5019-SC-1990-O\]](#), held that “The language used in section 80G(2)(a) is clear and unambiguous. The use of the expression ‘any sums paid’ contemplates payment of an amount of money. One of the dictionary meanings of the expression ‘sum’ means any indefinite amount of money. The context in which the expression ‘sums paid by the assessee’ has been used makes the legislative intent clear that it refers to the amount of money paid by the assessee as donation.”. Hence, in view of an absence of such definitive language in section 11, the legislative intent appears to be such as to include the non-monetary donations within the ambit of section 11(1)(d).

Further, this issue has been more specifically dealt with by Delhi ITAT in the case of *Sera Foundation v. ITO(E)* [\[TS-6294-ITAT-2012\(DELHI\)-O\]](#), wherein it was held that gifting of property as capital/corpus of the trust is permissible and shall be treated as corpus donation in the hands of the receiving trust. Relevant extract of said decision is also reproduced hereunder –

“It is evident that the shares were gifted towards corpus donation. The department has taxed the corpus donation as general donation by holding that the assessee was adopting colourable device. The first objection of department is that since assessee trust could not hold investment in the form of shares in view of section 11(5), therefore, it should not have accepted these shares.

*If the revenue's contention is to be accepted then it would imply that since a charitable trust is bound to keep its investments in the securities specified under section 11(5) then it should not have accepted the shares. This objection is **void of any merit** because there is **no restriction on accepting shares by a charitable institution.** [...]*

Dealing with the amendment in Section 11(1)(d)

With the amendment introduced in the provisions of section 11(1)(d) by Finance Act, 2021, the issue of non-monetary donation will become further interesting.

The amended provisions of section 11(1)(d) are reproduced as under:

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—

[...]

(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, subject to the condition that such voluntary contributions are invested or deposited in one or more of the forms or modes specified in sub-section (5) maintained specifically for such corpus.

In the above extract, the part highlighted in bold has been inserted by Finance Act, 2021. An additional

condition has been imposed to claim the benefit of section 11 with respect to corpus donations. A trust would be required to invest/deposit the corpus donations so received in the modes specified u/s 11(5) of the Act (read with rule 17C of the Rules).

Continuing with our example, shares of ABC Ltd are received as corpus donation and therefore as per the amended provisions, the same must be deposited/invested in the modes specified u/s 11(5). Since the provision requires investment/deposit of the contribution it can be said that the Trust would be required to liquidate the shares received and invest/deposit the amount received in one of the modes specified u/s 11(5).

Time allowed to liquidate the shares and make investment/deposit u/s 11(5):

It is pertinent to note that the amended provisions do not expressly specify the period of time within which the corpus donations are required to be invested/deposited in the prescribed modes.

Now, it would be irrational to consider that the donation has to be invested/deposited in prescribed modes immediately because the law requires a positive action (invest or deposit) on part of the trust, and so it is only logical to conclude that selling the donated shares/property and converting the same into cash would not amount to a change in the character of the cash so received and it can be said the amount received shall continue to remain a corpus donation.

To put this view into perspective, we may consider the case of the numerous charitable trusts/institutions receiving cash as corpus donations. It is pertinent to note that cash is not a mode specified u/s 11(5) and the same needs to be invested/deposited in the prescribed modes. In practical dealing, it is highly possible that there is a time lag between the receipt of corpus donation in cash and the investment/deposit of the same in one or more of the prescribed modes.

However, adopting the above rationale would not mean that there is no time limit for complying with the condition of investing/depositing the corpus donations in modes specified u/s 11(5).

In the language used in the initial part of section 11(1), it is stated as under:

(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—

On the perusal of the above, it can be understood that employing the phrase ***“not be included in the total income of the previous year”***, suggests the income of a trust is to be computed for each previous year and therefore the income in the form of voluntary contribution to corpus must be evaluated for each previous year.

Hence, if voluntary contribution to corpus is received in a previous year but is not invested in the specified modes *in that previous year*, then it cannot be said that the trust has received a contribution which qualifies as corpus donation u/s 11(1)(d). Therefore, such corpus donation would be treated as taxable income of such previous year.

To illustrate the above view, if Mr. X donates shares to the Trust as corpus donation in FY 2022-23, then, in order to claim exemption under section 11 of the Act, the Trust should ensure that such shares are liquidated and the amount so received on such liquidation is deposited/invested in one of the modes specified u/s 11(5) by the end of FY 2022-23.

Further, it is observed that section 13(1) seeks to disallow exemption u/s 11 to the trust if the said trust, *inter alia*, holds the shares in a company other than a public sector company or other than the shares prescribed u/s 11(5)(xii). However, clause (iia) of the proviso to Section 13(1)(d) provides that Section 13(1)(d) shall not apply, (i.e., exemption u/s 11 shall be allowed) if the asset is held in the modes, other than those prescribed u/s 11(5), for not more than 1 year from the end of the previous year in which the asset (i.e., shares) was received.

It must be noted that in case of *Sera Foundation (supra)*, Delhi ITAT held that the shares received as corpus donation must be deposited in accordance with section 13(1)(d) but a period of one year is

allowed for the same. Hence, this goes to provide further force to the interpretation as discussed above.

A very interesting issue originates from the above. What about capital gains in the hands of the trust on liquidation of shares for complying with the conditions of section 11(5)?

III. Capital gains on transfer of such corpus donation shares by the trust

As mentioned earlier, the shares in ABC Ltd donated to corpus of the Trust by Mr. X need to be liquidated by the Trust and then invested/deposited in one of the modes specified u/s 11(5) by the end of the previous year in which such donation was received by the trust. Such sale of shares would naturally give rise to capital gains in the hands of the Trust.

Note that in computation of capital gains on such shares, cost of acquisition shall be the same as in the hands of the previous owner by virtue of section 49(ii) read with section 47(iii) of the Act. However, the sale proceeds over and above such cost of acquisition (i.e., the amount of capital gains) shall form part of income derived from property held under trust and not of the corpus of the trust. Ideally, there would be a requirement for spending/applying 85% of said income from the sale of shares. For this purpose, the provisions of section 11(1A) must be considered for application of such capital gains.

On a perusal of section 11(1A), it can be appreciated that the capital gains on transfer of a capital asset held by the trust shall be deemed to have been applied for charitable purpose if the whole of the consideration received is invested in another capital asset.

Now, in our initial example, the Trust seeks to deposit the consideration received in a Fixed Deposit^[2] with a Scheduled Bank. *Does this satisfy the conditions of section 11(1A) for investment in another capital asset?* As per **CBDT Instruction No. 883 of 24-9-1975**, a fixed deposit held for 6 months or more by a charitable trust is treated as a capital asset. Therefore, in case the Trust holds the Fixed Deposits in the Scheduled Bank for more than 6 months, it shall comply with the requirements of section 11(1A) and such deposit would be treated as application for charitable purpose. Since such fixed deposit amounts to deemed application for charitable purpose in case of the capital gains from transfer of shares, no tax liability would arise in the hands of the Trust on such transfer.

However, it must be noted that if only part of the consideration received is deposited in Fixed Deposit, then only the amount by which, amount deposited exceeds the cost of the shares transferred would be treated as application for charitable purposes.

IV. Conclusion

Let's summarize the above analysis using our case scenario:

- Mr. X would be eligible to contribute shares of ABC Ltd as a corpus donation to the Trust.
- The Trust would be required to liquidate the shares so received as corpus donation and deposit/invest liquidation proceeds in the specified modes u/s 11(5) of the Act.
- The deposit/investment would have to be made in the same previous year in which the shares are received by the Trust.
- Capital gains on transfer of shares should be exempt in the hands of the Trust if whole of the consideration received on transfer of shares is deposited in a Fixed Deposit with a Scheduled Bank and such Fixed Deposit is held by the Trust for more than 6 months.
- If whole of the consideration is not deposited in the Fixed Deposit, capital gains shall be exempt only to the extent to which the sum deposited exceeds the cost of shares transferred. The cost of the shares would be taken as the cost incurred by Mr. X in accordance with section 49(1) of the Act.

[1] Refer Section 11(5) of the Act and Rule 17C of the Income-tax Rules, 1962 (the Rules)

[2] Note that for the sake of simplicity in understanding and continuity the example of fixed deposits has been employed. There are other modes prescribed in section 11(5) which may also qualify as a capital asset without warranting any further justification as was required for a fixed deposit.