New Retrospective Tax on 'Charitable Institutions'

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This article seeks to address amendments proposed to section 115TD vide Clause 57 of Finance Bill 2023. As per the proposal, Tax at Maximum marginal rate of 42.744% has been imposed retrospectively from 01.04.2022 (AY 2023-24) on Accumulated Corpus of charitable institutions which chose to not migrate to new registration regime u/s 12AB after expiry of old regime u/s 12AA w.e.f 01.04.2021.

In brief, all Charitable Institutions existing on or before 31-3-2021 were required to be registered u/s 12AA in order to avail tax benefits under sec. 11 to 13. The TAXATION AND OTHER LAWS (RELAXATION AND AMENDMENT OF CERTAIN PROVISIONS) ACT, 2020 inserted sub clause (5) to section 12AA by way of which Section 12AA was made ineffective from 1st April 2021 and therefore all institutions registered earlier u/s 12AA were deemed to be unregistered from such date i.e. 01.04.2021. An option was given to such Institutions to register u/s 12AB to continue to be governed by section 11 to 13. There was no mandate for all institutions registered u/s 12AA as of 31.03.2021 to seek such re-registration.

A certain class of charitable institutions evaluated that they did not intend to continue to take benefits of exemptions granted u/s 11-13. Consequently, they did not register u/s 12AB by the extended due date of 31st March 2022 and deposited advance tax as well as self-assessment tax for AY 2022-23 on maximum marginal rates and even filed their ITRs for AY 2022-23 on the same basis i.e. as Unregistered Trusts.

Now by way of proposed amendments, this action of non-registration u/s 12AB is being penalized retrospectively by taxing Accreted incomes of these trusts u/s 115TD at the maximum marginal rate from 01.04.2022 (AY 2023-24).

We argue that the proposed amendments are harsh, retrospective and contrary to consistent stand taken by the present Government against retrospective amendments and therefore there appears to be a need for review before the enactment of Finance Act 2023.

BACKGROUND OF SECTION 115TD

Section 115TD of the Income Tax Act 1961 was introduced by Finance Act 2016 w.e.f 1st June 2016 with an intention to tax Capital or Corpus funds of Charitable Institutions which convert into Non-Charitable Organisations or wind up their activities. Tax under Section 115TD, as it exists as of date, would only apply in case of charitable institutions which are covered under any of the following categories:

1. The institution has converted into any form which is not eligible for registration u/s 12AA or 12AB
2. The institution merged with an entity other than one registered u/s 12AA/12AB or one which is having different objects.
3. The institution has dissolved and has failed to transfer its assets to any other trust registered u/s 12AA/12AB within 12 months of dissolution

The term “converted into any form” mentioned in (a) above has been further deemed by sub section (3) to include following cases:

1. The registration granted u/s 12AA or 12AB has been cancelled or
2. The institution had undertaken modification of its objects and has either not filed for fresh registration or its application for registration was rejected.

All institutions which were covered under the above specified cases were required to pay tax at the Maximum Marginal rate of 42.744% on Fair Market value of their Net assets held on specified date, as per method prescribed.

AMENDMENTS PROPOSED BY FINANCE BILL 2023

Clause 57 of Finance Bill 2023 proposes to introduce a new class of specified persons whose accreted income shall be subjected to tax at maximum marginal rate w.e.f AY 2023-24 i.e. retrospectively from 1st April 2022. This has been done by adding new sub clause (iii) to sub section (3) of section 115TD, which specifies the persons which shall be deemed to have converted into a form not eligible for registration u/s 12AA/12AB and thus subjects them to pay tax at MMR on accreted incomes:

3. **Where trust fails to make application in accordance with sub clause (i), (ii) or (iii) of section 12A(1)(ac) within period specified under each of the clauses.**

Amendment has also been carried out to sub section (5) to specify that these specified persons and their principal officers, which fail to obtain registration within specified time shall be liable to pay tax within 14 days of end of the PY in which the period for obtaining registration expires.

Further amendment has also been carried out to Explanation to section 115TD to define “date of conversion” or date of valuation of accreted income to be the last date for making application for registration u/s 12A(1)(ac), in above cases.

IMPLICATION AND PURPOSES OF PROPOSED AMENDMENTS

Memorandum to Finance Bill 2023 discusses the purpose of these amendments in detail. As per the same, the amendment has been brought in to impose an exit tax on trusts which were earlier registered u/s 12AA but had voluntarily decided to not re-register u/s 12AB (covered under clause (i) of sec 12A(1)(ac)).

Similarly, it would also cover institutions which would not re-register u/s 12AB after obtaining provisional registration u/s 12AB (covered under clause (iii)) and institutions which do not re-register after expiry of 3/5 years (covered under clause (ii)).

The above amendments and them being effective from 1.4.2022 assumes significance given the fact that they would affect events of the past retrospectively especially in cases where trusts which were registered u/s 12AA had not opted to register u/s 12AB.

PONDERING ISSUES RELATING TO THE AMENDMENTS

The issues associated with the proposed amendments are manifold:

1. ***Retrospective application of the amendment***

As discussed in the introduction, vide The Taxation and Other Laws (Relaxation And Amendment Of Certain Provisions) Act, 2020 a switchover in registration regime of charitable institutions took place.

Earlier, all institutions had to be registered u/s 12AA to utilise exemptions u/s 11-13 however section 12AA was made ineffective from 01.04.2021 and further new registration was introduced u/s 12AB. The trusts which were registered earlier could re-register again u/s 12AB by 30.06.2021 (later extended to 31.3.2022).

However, this registration was not mandatory and was to be taken only if exemptions u/s 11-13 were to be taken by assessee. Further, as per section 115TD, there was no exit tax applicable on the class of institutions which did not re-register u/s 12AB as such institutions were not covered by the cases covered u/s 115TD. The only consequence of non-registration u/s 12AB was payment of tax at maximum marginal rates on incomes earned during the year.

This position remained the same as per Finance Act 2021 and Finance Act 2022 also which were enacted after the Taxation And Other Laws (Relaxation And Amendment Of Certain Provisions) Act, 2020 and continued as such until 31.03.2022 (last date to apply for registration u/s 12AB).

The institutions which therefore decided to not seek re-registration only took into account the costs associated with such decision as per law applicable on the date. Now, by way of proposed amendments in Finance Bill 2023, these decisions made on earlier dates are being prejudiced retrospectively and such these charitable institutions are being saddled with huge tax liabilities in form of tax at Maximum Marginal rate on their Corpus funds built over multiple years.

Such a retrospective tax goes against the spirit of constant assurances by Hon’ble Prime Minister as well as Hon’ble Finance Minister that no retrospective taxes shall be imposed on assessees.**In fact, recently when the retrospective effect of amendments after Vodafone case was withdrawn vide Taxation Laws (Amendment) Act 2021, the following was stated in its “Statement of Objects and Reasons” by the Honble FM:-**

“It is argued that such retrospective amendments militate against the principle of tax certainty and damage India's reputation as an attractive destination”

At the time, **Hon’ble Prime Minister called retrospective taxes to be mistakes of past and admitted that removal of retrospective taxes increase trust between government and assessees**.

Even the Hon’ble Supreme Court while rendering judgment in the landmark case of CIT vs Vatika Township Pvt Ltd, [2014] 367 ITR 466 [TS-573-SC-2014-O] stated in very clear terms that:

“The idea behind the rule is that a current law should govern current activities. Law passed today cannot apply to the events of the past and that if we do something today, we do it keeping in view the law of today and not tomorrow’s backward adjustment of it. ***Our belief in the nature of the law is founded on the bed rock that every human being is entitled to arrange his affairs by relying on the existing law and should not find that his plans have been retrospectively upset. This principle of law is known as lex prospicit non respicit : law looks forward not backward****.”*

The proposed amendments go contrary to above assurances of the Government as well as the basic principles of tax law as laid down by the Honble Apex Court.

2. ***Relevant Date of Liability***

As per section 12A(1)(ac)(i), the last date to apply for re-registration u/s 12AB was 30.06.2021. This was extended to 31.08.2022 vide Circular no. 12/2021 and further extended to 31.03.2022 by circular no. 16/2021. As per the proposed amendments, liability to pay tax on accreted income would arise on the expiry of last date for making application for registration as per section 12A(1)(ac)(i). Further, the valuation of accreted income shall be also done as of that date and tax on accreted income would also have to be paid within 14 days from the end of the PY in which this date falls.

As per literal interpretation, it would appear that liability for payment would arise on 31st March 2022 i.e. AY 2022-23 and as such accreted income shall be calculated on this date and further tax liability would have been payable by 14th April 2022.

However, the amendments themselves are being introduced from AY 2023-24 which would render them infructuous. It appears that the lawmakers were aware of such shortcomings and therefore in the memorandum to Finance Bill 2023, on Page 59, it has been mentioned that last date for applying registration u/s 12A(1)(ac)(i) was extended upto 25.11.2022 as per circular no. 22 of 2022. However, perusal of the said circular makes it clear that same was only a condonation of delay u/s 119(2)(b) and not extension of time u/s 12A(1)(ac). A condonation of delay even though issued to remove difficulties at large, does not lead to extension of time u/s 12A(1)(ac) which expired on 31.3.2022.

*3. **Specified persons***

Section 115TD only applies to specified persons. As per clause (iia) of Explanation, specified person only means a trust registered u/s 12AA or 12AB. As explained earlier, when section 12AA was made ineffective from 01.04.2021 by Sub section (5), registration granted under the said section also became ineffective from 01.04.2021. Further, the class of assessees in this case never applied for registration u/s 12AB. Therefore, from AY 2022-23 onwards, these institutions were unregistered u/s 12AA or 12AB and therefore not specified person u.s 115TD on the specified date. In such a case, the levy of tax on accreted income on such trusts does not come into question.

4. *Expanding the scope of Section 115TD*

At the time of insertion of section 115TD by Finance Act 2016, it was stated in the Memorandum that the section was being inserted to impose exit tax on institutions which convert into non charitable institutions. However, by way of proposed amendments, the scope is now expanded to cover institutions under its ambit irrespective of whether they become non charitable or not. Many trusts which have matured into self sufficient organisations continue to exist for charitable purposes but have opted to not claim tax exemptions voluntarily and have not registered u/s 12AB. Such trusts shall also now stand liable to pay the said Exit Tax despite continuing to do charitable activities.

CONCLUSION

From perusal of above discussion, it appears clear that the proposed amendments, if enacted as law, would tax past events which happened much before the date of the amendments. They would lead to undue tax burden on charitable institutions and lead to a fresh round of litigation. The recent stance of the Govt as well as the Honble Apex Court has been clear that tax laws should not be retrospective and therefore there is an urgent need to review these amendments.

Ideally, lawmakers should look to exclude cases u/s 12A(1)(ac)(i) and the amendments should only apply to sub clause (ii) and (iii) i.e. institutions which either do not seek re-registration after expiry of provisional registration u/s 12AB or after expiry of 3/5 years of registration u/s 12AB. Otherwise, even if such amendments are made applicable from 01.04.2022 also, even then institutions which still continue to do charitable activities while paying tax on their incomes shall be excluded from the ambit of section 115TD which would be in conformity with existing law.