

OPINION

Should charity be done directly or through a trust?

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SUMMARY

- *It is no longer feasible to run a charitable trust of a reasonable size on a part-time basis*

Should people donate directly or through a charitable trust? While the answer to this question does depend substantially on the facts, a considerable amount of thought needs to go into it, and various factors need to be considered (both tax and non-tax) in taking the decision as to whether one should set up a charitable trust or not.

From an income tax perspective, the charitable trust option does seem to be the better option, since donations to a charitable trust made by a donor are eligible for deduction of 50% under section 80G from the taxable income,

subject to certain limits. Besides, any amounts received by beneficiaries from a charitable trust are completely exempt from tax.

Therefore, the donor gets a tax deduction while the beneficiary is not taxed. Further, with a charitable trust, donations could be easily collected from similar philanthropy-oriented persons, and charity could be scaled up.

A donor who directly gives charity to a beneficiary, e.g. reimbursement of school fees or medical expenses, is not entitled to any deduction from his taxable income. The beneficiary also would also be liable to pay income tax on the amounts received, if the gross amount of such receipts exceeds ₹50,000 during the year.

Of course, if the donor pays the amount directly to the educational or medical institution rather than the beneficiary, the latter would not be liable to tax on such amount.

The tax advantages of having one's own charitable trust, through which one could carry on charity, have to be weighed against the significant disadvantages that running a charitable organization entails.

Today, a charitable organization is far more regulated than even a business enterprise. It has to comply with state charity regulations, stringent income tax provisions, as well as the perplexing regulations governing foreign contributions in the form of the Foreign Contribution (Regulation) Act.

The punishments and penalties under these laws have been enhanced in recent years. Clerical errors and slight delays could invite significant punishments. To illustrate a few instances: if the income tax return or the audit report is filed late even by a day or two, it could result in loss of income tax exemption for the year.

If the application for renewal of registration is not filed by the due date (6 months before expiry of the earlier registration), tax is payable at the maximum rate on the fair market value of the assets of the trust, after deducting liabilities, resulting in around 40% of the trust being wiped out.

If a trust receives a corpus donation (towards its capital) and it is not invested in approved investments by the year-end, the corpus donation does not qualify for exemption, unless it is actually spent. There are many more mistakes which could invite loss of exemption, penalties and punishments.

Running a charitable trust with income tax exemption is therefore a full-time job, requiring competent administrative staff and knowledgeable advisers. It

is no longer feasible to run a charitable trust of a reasonable size on a part-time basis. The cost of administration of such a trust is therefore now significant, even if the trust does not have any other employees, which one has to factor in.

Many potential philanthropists, who wish to test the waters, are often put off by so much red-tape and bureaucracy involved in the compliance, with focus being diverted from charity. The reason given for such stringent provisions is the misuse of the tax exemptions by a few trusts.

So, should the tax laws be enacted so as to deter all, so that only the very few are able to claim exemption, just to prevent misuse by a few? Every tax exemption given in the past has resulted in misuse by a few—exemptions for poultry farming, hotels, long-term capital gains on sale of listed shares, etc. Even the exemption for agricultural income is being misused. But no action is taken on that front. Why is action only taken against genuine charities for misdeeds of a few?

Fledgling businesses (startups) are being encouraged with lesser compliances and easier tax provisions. Can the same not be done for charitable trusts, with simpler provisions for smaller trusts (say, with incomes below ₹10 crore), and only larger trusts (which have the administrative capacity) facing more strict compliance?

This would encourage the incubation of much-needed charitable entities, which would support the government in social activities. As they grow, they would then be in a position to face increased compliance.

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