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Trusts fear new tax to shrink coffers, hurt charity work

By Sugata Ghosh, ET Bureau Last Updated: Feb 28, 2024, 12:43:00 AM IST

Synopsis
Large trusts and non-profits are in dilemma as the March 15 deadline for advance tax approaches. The new law taxes the money given by larger trusts to smaller NGOs. Clarification by the CBDT is needed to address the impact on flow of funds to charitable causes and to provide tax exemptions for sub-grants.

Mumbai: Large **trusts** of corporate houses, CSR foundations, and many non-profits are in a dilemma as the March 15 deadline for advance **tax** approaches.

The bone of contention is a new law that kicked in from FY24 and imposes a tax on the slice of the money that larger trusts give to smaller **NGOs** doing the grass-roots work, often in remote regions.

Since several big trusts and **corporate social responsibility** (CSR) arms pass on sizeable amounts to smaller trusts having direct connection with the beneficiaries of charity activities, the tax - though brought in to curb misuse and rotation of funds among group trusts without spending it for the actual causes - would hurt both big and small **nonprofits**.

A trust is allowed to set aside and accumulate 15% of its donations. Until now, the balance could have been either spent by the trust in charitable work or given away as a sub-grant to other trusts which do the groundwork and spend the money to benefit the underprivileged. However, from this year, 15% of the amount given to other trusts would be taxed. Say, a large trust, after accumulating 15% out of its total **donations** and **grants** towards building its corpus, is left with ₹100 crore; now, if it distributes the money to various smaller trusts, it would be taxed on ₹15 crore, causing a tax outgo of almost ₹5 crore.

"There is significant uncertainty as to whether the balance 15% of donation to other trusts would be taxable, or is eligible for the 15% accumulation, since the funds would not be available, having been already disbursed. Unfortunately, there is no clarity in this regard. If taxed, large trusts which disburse funds to smaller trusts could be significantly impacted, affecting the overall flow of funds to charitable causes. Since the intention of the law is different, a clarification by the CBDT would greatly help," said Gautam Nayak, partner at CNK & Associates, which advises a number of charitable trusts.

The statute is aimed to plug the practice where a trust passes on 85% of the grants to a related trust, which after retaining 15% of the amount received passes on 85% to another group trust, which then moves money to another outfit. As a result, the donations never reach the needy. However, the fear is that in putting an end to this sharp practice, many genuine trusts would be affected.

"We did not expect any clarification on this in the interim budget. But trusts and industry bodies have made multiple representations so that the government addresses this in the final budget in June. Such sub-grants could be either fully tax exempt or some mechanism should be proposed," said an official of a well-known charitable trust backed by one of the largest business houses.

According to Dr Gautam Shah, partner of the CA firm Gautam Shah & Associates, when this provision was introduced in the Parliament in 2023, it was clear that this was brought in to curb round-tripping of funds. "But, the amendment would deter many grass-roots trusts from receiving any donation from other trusts for carrying out genuine charitable activities at the ground level. Therefore, the benefit of accumulation or setting apart of income up to 15% under Section 11(1)(a) of the Income Tax Act, 1961, should be applicable and only the round-tripping of donation should be taxed," said Shah.

Under the circumstances, a larger trust can avoid tax if it chooses to directly fund the beneficiaries, bypassing the smaller trusts. But, this may not be a practical solution.

"Also, if the larger trust opts to grant its entire donations to another trust, potential tax liabilities could be mitigated, factoring in a 15% deduction. However, this approach presents a conundrum, as it leaves the larger trust without resources for its operational needs," said Paras Savla, partner at the tax and advisory firm KPB & Associates.

Many trusts may refrain from paying advance tax on the 15% of the amount given to other trusts till they go through the fine print of the **finance bill** in the June Budget. Since such a law amounts to taxing a part of the donation, they are unwilling to dip into their coffers to fork out tax.