

Tax exemption for trusts: Spending in India or benefit in India?

Gautam Nayak 2nd September 2024

Summary

The income Tax Tribunal allowed Tata Trusts' tax exemption on loan scholarships for Indian students studying abroad, ruling the funds were applied in India. The case raises questions on why tax exemptions depend on where money is spent rather than who benefits.

A recent decision by the Mumbai bench of the Income Tax Appellate Tribunal in the case of one of the Tata Trusts has brought attention to a challenge faced by many charitable trusts in claiming tax exemptions for spending on charitable activities. The case involved the trust providing loan scholarships to Indian students pursuing higher education abroad.

Under Indian law, charitable trusts are entitled to tax exemption for income applied to charitable purposes in India. If the funds are used for charitable purposes outside India, exemption is allowed only if the activity promotes international welfare that India is interested in, and with prior approval from the Central Board of Direct Taxes (CBDT).

The tax authorities have held that spending has to be in India, even if the benefit flows to the public in India to qualify for exemption. The trusts' contention has often been that the charitable purpose has to be in India, i.e. the benefit of the spending has to flow to the public in India.

The extreme view taken by the tax authorities in this Tata Trust case was that both spending and the purpose of spending have to be in India. According to the tax officer, by giving loan scholarships for higher education to Indian students for overseas studies, the trust was spending for the charitable purpose of education outside India since the loan was given for spending on education outside India. Therefore, tax exemption was denied to the trust in respect of such loan scholarships given to students.

The tribunal held that the application of the money by the trust was complete once the funds were disbursed by the trust to the students in India, and therefore this was application for charitable purposes in India.

According to the tribunal, the fact that the students spent the money on overseas education was not material for the purpose of the trust's exemption, and therefore, the tribunal allowed the trust to be exempt from such expenditure on loan scholarships. In doing so, the Tribunal followed a Delhi High Court decision, which had taken the view that the spending had to be in India, and not the purpose of the spending, to qualify for exemption.

The facts of this case were such that the benefit was also flowing to students who were resident in India at the time of receiving the scholarships. Such an interpretation of requiring the place of spending to be in India and not the charitable purpose does however give rise to a question as to why the law should be framed in such a manner, that money spent in India for the benefit of non-

residents is eligible for tax exemption, while money spent outside India for the benefit of Indian residents is not.

There are numerous such examples. One was a case before the Karnataka high court, where payment was made to a foreign university by an Indian university, for foreign teachers who came to India to teach Indian students. The high court held that since the purpose was in India, the exemption was to be allowed even though the spending was outside India.

There are similar cases where educational institutions pay examination fees or fees for curriculum to foreign universities, send Indian students to foreign universities for a few months as part of the course for which they pay the foreign university.

There are also cases where Indian students are sent on foreign study tours, where hospitals pay foreign hospitals or consultants for advice on latest and best practices or for deputation of their doctors to the foreign hospitals.

Then there are cases where trusts organize exhibitions overseas to promote their activities in India or pay membership fees to overseas organisations for research or consultancy in relation to their Indian activity.

In all of the above cases, the benefit of the expenditure is the charitable activity carried out in India and the Indian public, though the money may be spent outside India.

Need for legal clarification

Should such expenditure for the benefit of residents not qualify for the exemption, rather than expenditure spent in India for the benefit of non-residents? Why should availability of the expenditure depend upon where it is spent, rather than why and for whose benefit it is spent? The purpose of grant of tax exemption to charitable entities is to encourage them to support the government in uplifting the lot of Indian residents – the interpretation now being given by the tax authorities is at cross-purposes with that intent.

Should the law not be amended or clarified by issue of a circular to address the inconsistencies and achieve the real purpose of the exemption? Only this will ensure that genuine charity intended for the benefit of the Indian public gets the exemption and that trusts are not placed at a disadvantage for trying to ensure that the Indian public gets the best of what the world has to offer.

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