

CAPITAL GAINS

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APPLICABILITY OF PROVISIONS OF SECTION 50C TO NGOs



Standards & Norms

Resource support on NGO Governance, Accounting and Regulations



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APPLICABILITY OF SECTION 50C AND SECTION 11(1A)

- 1.01** Section 50C of the Income Tax Act, 1961 is applicable when the consideration received or accrued on transfer of capital assets (building or land or both) is less than the value adopted by State Stamp Duty Valuation Authority. Under section 50C read with Section 48 if the property is transferred or sold below the circle rate or the stamp value then the stamp value of the property shall be deemed to be full value of consideration received or accruing as result of transfer.
- 1.02** In other words, section 50C is a **deeming provision** where value as per the State Stamp Duty Valuation Authority shall be deemed to be full value of consideration for the purpose of capital gain in cases where sale consideration is lower than stamp duty valuation.
- 1.03** Section 11(1A) provides that for the purpose of section 11(1), where a capital asset held wholly for charitable or religious purpose is transferred, and the whole or any part of the net consideration is utilized for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified thereunder.
- 1.04** It would also be pertinent to note that section 50C was inserted into the Income-Tax Act much after section 11(1A) was introduced. However, the legislature has not chosen to amend section 11(1A) after the insertion of section 50C.
- 1.05** Section 11(1A) was brought into the statute to do away with the erosion of the corpus. Thus, when the intention of the Legislature was to ensure that there is no erosion of corpus by way of requiring application of actual income, it can never be the intention of the Legislature to import section 50C into section 11(1A) and require the application or utilization of an artificial sum, thereby eroding the corpus.

- 1.06** It can never be the intention of the Legislature to give a benefit with one hand and then take the same away with the other. Hence, a sincere attempt must be made to reconcile the provisions to ensure that the benefit given by the legislature is not taken away. In this regard, reference may be made to the judgement of **Goodyear India Ltd. Vs. State of Haryana [1991] 188 ITR 402(SC)**.

JUDICIAL PRECEDENCE ON NON APPLICABILITY OF SECTION 50C

- 2.01** The trust registered under section 12AB of the Income-tax Act, 1961 are subject to sections 11, 12 & 13 and normal provisions under various heads of income are not applicable. Therefore, Section 50CA, being part of provisions related to income from capital gain, has no applicability to a trust registered under section 12AA of the Income Tax Act, 1961.
- 2.02** The capital gain of a charitable or religious organisation is required to be computed under section 11(1A) of the Income Tax Act.
- 2.03** It has been specifically held that the provisions of section 50C are not applicable to charitable organisations registered section 12AB; in other words, section 11(1A) cannot be substituted with section 50C. In the case of *ACIT-1 Kanpur v. Upper India Chamber of Commerce* ITA 601/LKW/2011, it was held that section 50C is not applicable to charitable organisation. The other cases relevant in this regard are as under:
- i. *Sri Guru Dattatreya Mattum v. Income Tax Officer (Exemptions) Ward Guntur*, **2020 (3) TMI 543 - ITAT Visakhapatnam.**
 - ii. *DCIT v. Saife Jubilee High School* (Ahmedabad ITAT ITA No. 2301/Ahd/2014) [2018 (11) TMI 540 - ITAT Ahmedabad]

- iii. *ACIT-1 Kanpur v. Upper India Chamber of Commerce* ITA 601/LKW/2011 [2014 (11) TMI 395 - ITAT Lucknow]
- iv. *CIT v. Thiruvendgam Investments Pvt. Ltd.* 2009 (12) TMI 48 - Madras High Court.

- 2.04** In the light of the above judgments the deemed fair market value of the property cannot be considered for the purposes of the calculation of capital gains, as the provisions of section 50C of the Income-tax Act, 1961 cannot be invoked and the assessment of charitable organisations is required to be completed by following the provisions of section 11(1A) which is a separate code for taxation of capital gains.
- 2.05** Further, 'Net Consideration' and 'cost of the transferred asset' for the purposes of section 11(1A) of the Income-tax Act, 1961 has been separately defined in the *Explanation* to the said section.
- 2.06** It is apparent from the above that though, the cost of transferred assets is computed as per the provisions of sections 48 and 49, determination of net consideration for the purposes of the said section has no reference to sections 48 and 49. It is computed as defined in *Explanation* to this section.
- 2.07** Further, the provision of section 11(1A) are specific provisions whereas provisions of section 50C are general provisions and that provisions of section 50C do not start with a *non obstante* clause. Thus, as per the rules of interpretation, specific provisions override general provisions. The principle is *Generalia Specialibus Non Derogant* which implies that general provisions must yield to the special provisions. Moreover, the sections in the Act do not overlap one another and each section deals only with the matter specified therein and goes no further. If a case appears to be governed by either of two provisions, it is clearly the right of the assessee to claim that he should be assessed under the one, which leaves him with a lighter burden.

- 2.08** The literal meaning of the expression '*Generalia Specialibus Non Derogant*' is that general words or things do not derogate or detract from the specific. The Courts have held the expression to mean that when there is a conflict between a general and special provision, the latter shall prevail, as held in the cases of *CIT v. Shahzada Nand & Sons* [1966] 60 ITR 392 (SC) and *UOI v. Indian Fisheries (P.) Ltd.* AIR 1966 SC 35, or the general provisions must yield to the special provision.
- 2.09** Thus, by virtue of the above, specific provisions, whether they apply to taxing of capital gains or to the definition of 'Net Consideration', section 11(1A) being a section enacted specifically for the trusts shall prevail over section 50C.

NON-APPLICABILITY FIVE HEADS AND CBDT CIRCULAR

- 3.01** Section 11 of the Income-tax Act deals with computation of income from property held for charitable and religious purposes. Section 11(1) provides the incomes that shall not be included in the total income of the previous year of the person in receipt of the income.
- 3.02** It is well settled that the 'income' as referred to in section 11(1) must be computed in accordance with commercial principles and not in accordance with the ordinary provisions of the Act. In other words, section 14 and five heads of income will not apply to organisation registered under section 12AB.
- 3.03** The CBDT Circular 5-P(LXX-6) Dt.19th June 1968 has clarified that the word 'income' in section 11(1)(a) must be understood in a commercial sense and five heads of income as per section 14 are not applicable. This circular has specifically included that *where the trust derives income from house property interest on securities, capital gains, or other sources, the word "income" should be understood in its commercial sense.*

JUDICIAL PRECEDENCE ON NON-APPLICABILITY OF SECTION 14

4.01 In *CIT v. Estate of V. L. Ethiraj* [1982] 136 ITR 12 (Mad.), it was held that income from properties would have to be arrived at in the normal commercial manner without reference to the provisions which were attracted by section 14. In this case, the Court observed that the language of section 11(1)(a) makes it clear that the income derived from the property held under trust wholly for charitable and religious purposes, to the extent to which such income is applied to such purposes in India, is excluded. When once the income from the property, as such, is excluded, there is no question of computing the income from the property by applying the provisions of section 14.

4.02 ***'Income' must be understood in commercial sense, and not as 'total income' as assessed:***

It is not the 'total income' as would be assessed by the ITO that is relevant for the purpose of investing the funds of the trust or assessing the income of the trust. Taking into account the purpose for which the conditions of section 11(1)(a) are imposed, it would be clear that 'income' to be considered will be that which is arrived at in the context of what is available in the hands of the assessee subject to an adjustment of any expenses extraneous to the trust – *CIT v. P.S.G. & Sons Charities* 1996 Tax LR 477 (Mad.), See also – *CIT v. Programme for Community Organisation* [1997] 228 ITR 620 (Ker.).

4.03 ***Heads of income under section 14 have no relevance and question of allowing statutory***

deductions will not arise: The 'income' contemplated by the provisions of section 11 is the real income and not the income as assessed or assessable. Since the income from property held under trust has to be arrived at in a normal commercial manner and when the income from property held under trust as such is excluded, there is no scope of computing the income from property by applying the provisions of section 14 of the Act. Therefore, the question of allowing any statutory deductions as contemplated by the different provisions of the Act dealing with different heads of

income in computing the income accumulated does not arise when the trust loses the benefit of accumulation – Director of Income-tax v. Girdharilal Shewnarain Tantia Trust [1993] 71 Taxman 150 (Cal.). Therefore income is computed on commercial sense and not under five heads of income including profit and gains from business.

4.04 Separate provision for Capital Gain [Section 11(1A)]: Hence from the above analysis it is quite clear that heads of income including capital gain is not applicable for a charitable institution and therefore Section 50C being part of computation provisions of calculating capital gain under the head ‘Capital Gain’ is not applicable to charitable institution subject to section 11 to 13.

IMPOSSIBLE TO APPLY WHICH IS NOT RECEIVED

5.01 Section 50C is a deeming section to check tax evasion, however, in case of charitable organisation the entire capital gain irrespective of the quantum of consideration received is exempt from tax subject to the conditions under section 11. Therefore, section 50C which taxes the income which was not actually received in the books of account cannot be applied to the charitable organisation for two reasons:

- (i) Firstly, unlike normal Income Tax assessee, increase in the capital gain will increase the tax liability. Therefore, there is a possibility that the assessee may under value the transfer of property to save taxes. However, in case of charitable organisation any amount of capital gain will not be subject to any tax even if the organisation keeps such amount in long term fixed deposits with banks. Therefore, there is no question of tax evasion by under valuing the transfer of asset.
- (ii) A charitable organisation cannot be expected to either apply or pay taxes on the amount which it has never received. A charitable trust cannot be expected to do the impossible act of applying/accumulating/investing a

notional consideration that it has neither received nor is going to receive. In this regard, reference may be made to the judgements in *Krishnaswamy S. Pd. Vs. Union of India* [2006] 281 ITR 305(SC) and *Engineering Analysis Centre of Excellence Private Limited vs. CIT* [2021] 125 taxmann.com 42(SC).

TRANSFER OF PROPERTY FOR LOWER CONSIDERATION TO INTERESTED PERSONS UNDER SECTION 13(3)

6.01 It is to be noted that Section 13(3) provides a list of persons who are treated as interested persons for the purposes of section 13(2). They are as follows:

- (i) author of the trust or founder of the institution;
- (ii) person who has made a substantial contribution to the trust or institution, i.e. any person whose total contribution up to the end of the relevant previous year exceeds ' 50,000;
- (iii) where such author, founder or person is a Hindu undivided family, a member of the family;
- (iv) any trustee of the trust or manager (by whatever name called) of the institution;
- (v) any relative of any such author, founder, person, member, trustee or manager as aforesaid;
- (vi) any concern in which any of the persons referred to in (1) to (5) above has a substantial interest

It is also to be noted that the types of specified benefits u/s. 13(2) includes –

- Making available building or property of the trust for the use of the specified persons without charging adequate rent or other compensation, [clause (b)].
- Diversion of income or property of the organization in excess of ' 1,000 to any of the specified persons, [clause (g)].

6.02 Hence If the sale of trust property including land & building is made at a consideration lower than the value as per the Stamp Valuation Authority then it will tantamount to passing of benefit to a specified person in terms of Section 13(1)(c) read with section 13(2) of the Income Tax Act, 1961 and thereby it shall be subject to tax @ 30% under section 115BBI and this benefit shall also be subject to tax penal provision under section 271AAE.

6.03 Section 56 has also been amended by Finance Act, 2022 and it has been provided that the specified person shall also be subject to tax under section 56 for such benefits as specified in section 13(2) is received by them.

6.04 Hence **sale** of trust property including land & building at a lower consideration to specified person shall result into taxation at both the hands i.e

(i) In the hands of charity

- a. Income computed on commercial principle i.e on the basis of sale consideration shall be the income subject to application or subject to section 11(1A)
- b. The amount of benefit i.e excess of value as per the Stamp Valuation Authority over the actual sale consideration shall be subject to Tax@ 30% under section 115BBI and this benefit shall also be subject to penal provision under section 271AAE.

(ii) In the hands of specified person as income from other sources subject to tax under section 56.

Further, the transfer of property to interested person for a lower consideration may also lead to cancellation of registration under section 12AB(4) & (5)

RESTRICTIONS ON TRANSFER UNDER INDIAN TRUST ACT, 1882

7.01 There are certain restrictive provisions with regard to transfer of property under the Indian Trust Act, 1882. Normally, the Indian Trust Act, 1882 does not apply to a religious or charitable trust, however, the Allahabad High Court in the case *Mahant Som Giri vs Mahant Ram Ratan Giri And Ors.* on 26 August, 1941, AIR 1941 All 387 held that the principles underlying the sections of Indian Trust Act, 1882 should serve as a guide to charitable and religious trust also. The relevant sections of Indian Trust Act, 1882 are as under:

“Section 36: General authority of trustee.—In addition to the powers expressly conferred by this Act and by the instrument of trust, and subject to the restrictions, if any, contained in such instrument, and to the provisions of section 17, a trustee may do all acts which are reasonable and proper for the realisation, protection or benefit of the trust property, and for the protection or support of a beneficiary who is not competent to contract. 1[***] Except with the permission of a principal Civil Court of original jurisdiction, no trustee shall lease trust property for a term exceeding twenty-one years from the date of executing the lease, nor without reserving the best yearly rent that can be reasonably obtained.”

“Section 37: Power to sell in lots and either by public auction or private contract.—Where the trustee is empowered to sell any trust property, he may sell the same subject to prior charges or not, and either together or in lots, by public auction or private contract, and either at one time or at several times, unless the instrument of trust otherwise directs.”

7.02 Thus, in case of charitable and religious trusts, the trustees have an inherent obligation to act in the interest of the trust and its beneficiary and/or in other words, in public interest. Public interest demands that any transfer or alienation of the trust property should be completely transparent, fair and in public interest. It is, therefore, expedient

that all transfers of property held by religious or charitable trusts, should be open, by issuance of public notices and/or advertisement. The transfer should be given sufficient publicity to fetch the best offers. Some relevant Judicial pronouncement are as under:

- a) In **Mohan Lall Seal & Ors. v Kanak Lall Seal & Ors. G.A. No. 3095 of 2008 C.S. No. 116 of 2008** it has been held that:

“Under Section 36 of the Indian Trust Act, it was necessary to obtain permission of the principal Civil Court of original jurisdiction to execute a long term lease, exceeding 21 years. Even though the trust was a charitable trust to which the Indian Trusts Act did not apply all the principles embodied in the Indian Trusts Act would apply.”

- b) The **Supreme Court in Committee of Management of Pachaiyappa’s Trust vs. Official Trustee of Madras & Anr. AIR 1994 (1) SCC 475**, has held that lease of trust property should be granted by public auction.
- c) In **Venugopala Naiduvs. Venkatarayulu Naidu Charities AIR 1990 SS 444** the Supreme Court held that the Court should not permit property belonging to religious and charitable endowments to be transferred by private negotiations.

Therefore, if the sale consideration are found to be lower than the market value, the entire sale transactions may be under scrutiny in terms of specific provision as per Indian Trust Act 1882.

CONCLUSION

As discussed above, we find section 50C does not have any application in the case of charitable trust. The capital gains shall be computed in commercial sense and shall be

subject to section 11(1A). Any other interpretation will lead to the absurd result of requiring a charitable trust to apply/accumulate/invest notional gains which have never accrued or arisen to it and this can never be the intention of the Legislature. However, an organisation should be careful about any such transfer to interested person and also be mindful of section 36 and 37 of Indian Trust Act, 1882 which requires that the trustees should follow proper transparent procedure for transfer of trust property.

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