CAPITAL GAIN OF TRUSTS

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RE-INVESTMENT OF CAPITAL GAINS IN FIXED DEPOSITS

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Financial Management Service Foundation
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CONTENTS

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SUMMARY

1.01 'Income', as defined under section 2(24) of the Income Tax Act, 1961, includes capital gains; therefore, for Trusts and NPOs capital gains are also considered part of the income, subject to the 85% application requirement. However, such trusts can avoid the application of capital gains by re-investing the entire sale proceeds(not just the capital gains) into fixed deposits without any tax implications.

1.02 As capital gains are considered as part of income, they can be utilized for charitable or religious purposes. Charitable trusts are assessed under section 11 and are not subject to section 14 & the five heads of income. Therefore, capital gains for such trusts must be calculated on a commercial basis.

1.03 If capital gains are also required to be applied for charitable and religious purposes, it will amount to the depletion of the corpus of the organisation. In order to overcome this disadvantage, the Income-tax Act has introduced section 11(1A).

1.04 Under section 11(1A), if the entire amount of net consideration is invested in another capital asset, then the entire capital gain will be deemed to have been applied for charitable or religious purposes. Under section 11(1A), if part of the entire amount of net consideration is invested in another capital asset, then the amount in excess of the amount utilised (in acquiring another asset) over the cost of the transferred assets will be deemed to have been applied for charitable or religious purposes. The remaining capital gains will be subject to 85% application.

1.05 Capital gain has to be reinvested in another capital asset in the same year, unless the assessee exercises the option available under the *Explanation* to section 11(1), to apply the income in the subsequent year.

1.06 *Explanation* (*ii*) to section 11(1A) provides that the cost of the transferred asset should be ascertained as per sections 48 and 49. Section 48 provides for the indexation of the cost of the asset. Therefore, if provisions of section 11(1A) are applied, indexation benefit can be claimed. In other words, the cost of the transferred asset shall be indexed only for the purposes of section 11(1A).

1.07 If the entire sale proceeds are used for the purchase of another capital asset, then the entire capital gain (calculated on the basis of indexation) shall be deemed to have been utilised.

1.08 There are primarily three options available for the treatment of capital gain:

(i) an organisation may compute capital gain without taking the indexation benefit and apply the capital gain for charitable purposes up to 85% under section 11(1)(a). In this case, the cost of the transferred assets will be the cost without indexation.

(ii) an organisation may not compute capital gain and re-invest the entire sale proceed in another capital asset. In this case, the capital gain shall be exempt under section 11(1A) and there will be no need for application under section 11(1)(a).

(iii) if an organisation invests a part of the sale proceed in another capital asset, then capital gain should be computed based on the indexed cost and the amount in excess of amount utilised (in acquiring another asset) over the cost of the transferred assets will be deemed to have been applied for charitable or religious purposes. The remaining capital gain will be subject to 85% application. In this case, the cost of the transferred assets will be the cost after indexation.

1.09 The Finance (No. 2) Act 2024 has amended the second proviso to Section 48 to provide that no indexation benefit shall be available in respect of the long-term capital assets transferred on or after 23-07-2024.

1.10 The sale proceeds or net consideration itself will be treated as capital gain if the transferred asset was claimed as application against income.

1.11 Investment in fixed deposit is considered as an investment in capital asset. CBDT Instruction No. 883, dated 24-9-1975, specifies that such fixed deposits should be for 6 months or more, but various High Courts have held that such 6 months' time-limit is legally not valid. The nature of asset is important and not the time-frame.

1.12 Capital gain normally arises at the time of transfer, and therefore, normally the reinvestment period should be after the date of transfer. However, in case of charitable organisations, it is reasonable to re-invest in a new capital asset only after the consideration is received. Similarly, if a trust or NPO receives advance amount even prior to the transfer of the capital asset, the reinvestment can be done even prior to the sale of asset.

1.13 No time-limit has been provided under section 11(1A) to retain the new asset. Under the prevailing provisions, each year's income and its application are treated separately for the purposes of exemptions. Therefore, if the asset is held at the year-end of the relevant previous year and is disposed of in the subsequent year, then the exemption cannot be denied nor can it be withdrawn in the next year.

1.14 Provisions of section 50C do not apply to charitable trusts registered under section 12AA/12AB.

OVERVIEW

2.01 Capital gains are the gains arising when a capital asset is sold at a price which is higher than the cost of acquisition. As per section 2(14), a capital asset includes every property held by the assessee, being movable or immovable. However, some personal assets and rural agricultural land are not considered as capital assets.

2.02 Under normal provisions of the Income-tax Act, income is computed under the five heads of income and income from capital gains is one of them. Part E of Chapter IV of the Income-tax Act contains provisions for the computation of income from capital gains. 'Income', as defined under section 2(24), includes capital gains; therefore, for the purposes of section 11(1)(a), capital gains are also considered as part of the income. However, there are special provisions for the computation of capital gains under section 11(1A) of the Income-tax Act.

2.03 Section 11(1A), which deals with the treatment of capital gains, was not there during the inception of the Income-tax Act. In the absence of any provision related to capital gains, all charitable or religious organizations were required to apply the capital gains for charitable purposes under the provisions of section 11(1)(a). The requirement of utilizing capital gains on fulfilment of the objects of the organization resulted in depletion of the corpus. Section 11(1A) allowed an option to charitable and religious organizations whereby they could re-invest the sale proceeds from capital assets in new capital assets so that in the long run the corpus would remain intact.

QUERIES

3.01 ***Query No. 1.: A trust registered under section 12AB sold a property for Rs. 2 crore and generated capital gain of Rs. 1 crore. In this case will the tax liability be Nil if the trust keeps the entire sale consideration in Fixed Depositsof 6 month tenure or it should be for 12 months?***

Investment in fixed deposit is considered as an investment in capital asset. The CBDT Instruction No. 883, dated 24.9.1975, specifies that such fixed deposits should be for 6 months or more. The relevant extract of the CBDT instruction is reproduced as under:

> *"The Board has been advised that investment of the net consideration in fixed deposit with a bank for a period of six months or above would be regarded as utilisation of the net consideration for acquiring 'another capital asset' within the meaning of s. 11(1A) of the IT Act, 1961."*

The CBDT instruction is provided in ***Annexure - 1***. However, it is recommended that fixed deposits for a period of 1 year should be created, which will ensure that the fixed deposits do not get liquidated within the year of receipt of capital gain.

The capital gain earned by NPOs is also considered a part of the Income and therefore, it is subject to 85% application during the year. However, the Income Tax Act provides exemption against such gain if the entire amount of sale proceed is reinvested in another capital asset.

Income as defined under section 2(24), includes capital gains. Therefore, for the purposes of section 11(1)(a), capital gains are also considered as a part of the income. Therefore, all NPOs have **two options**:

(i) they can apply 85% of capital gain for charitable purposes or invest the entire amount in another capital asset

(ii) the Income-tax Act has provided another option under section 11(1A), by virtue of which capital gains can be re-invested in another capital asset. It will be treated as valid application of income.

Under section 11(1A), if the entire amount of net consideration is invested in another capital asset, then the entire capital gain will be deemed to have been applied for charitable or religious purposes.

Under section 11(1A), if a part of the entire amount of net consideration is invested in another capital asset, then the appropriate fraction of the capital gain will be deemed to have been applied for charitable or religious purposes.

3.02 ***Query No. 2: Out of the sale consideration of Rs. 2 crore a sum of Rs. 10 lakh was applied for charitable purposes and remaining Rs. 1.9 crore was invested in Fixed Deposits. Further, the re-investment was made after 2 months of receipt of sale consideration.***

The entire sale proceeds has to be re-invested in another capital asset in the same year. The gap of 2 months in reinvestment into fixed deposits will not make any difference, the organisation can make reinvestment within the financial year in which the capital gain arose and was received.

In context of Rs. 10 lakh applied for charitable purposes, we have to understand that sale consideration and capital gain are two different things. In this case 5% of the sale consideration has been applied for expenses. If such 5% is applied towards advancement of objects then there will be no tax implication, it will only denote that the organisation has partially applied the option available under section 11(1A) and partially applied the capital gain for charitable purposes.

3.03 *Query No. 3: In case the fixed deposits are liquidated after 6 months i.e. before maturity, what are the implications regarding capital gains?*

As such no time-limit has been prescribed for retention of the new asset for a specified period for availing of the exemptions under section 11(1A). In other words, if the fixed deposits are liquidated after a period of 6 months subject to condition that the 6 months period is completed only after the financial year then there will be no tax implication or violation of any provisions. In *Dalmia Charitable Trust v. ITO* [1986] 27 Taxman 46 (Mag.), the Delhi Tribunal held that when the amount of capital gain was invested in a new capital asset and the new asset was also disposed of in the same year, then the exemption under section 11(1A), was not permissible. In other words, the sale proceed is required to be invested in a new capital asset and such new capital asset cannot be liquidated in the year of creation/acquisition. Incidentally fixed deposit is also treated as an capital asset.

However, the interest earned shall be subject to 85% application. Therefore, whenever a capital asset is disposed of the benefits of section 11(1A) can be availed of by re-investing these into other capital assets. The capital gains under section 11(1A) are not distinguished as 'short-term' or 'long-term' capital gains; any capital gains are permissible under section 11(1A). It is recommended that the term deposits are created for a tenure of 1 year or more and are not liquidated before maturity.

3.04 *Query No. 4: Once the FD is broken, should the entire amount of fund be utilised for activities in the year in which it is liquidated?*

Legally, only the interest amount is required to be applied in subsequent years. Therefore, the organisation is entitled to retain the amount at its discretion. In other words, the organisation will be entitled to keep the funds in section 11(5) investments without any obligation to spend for charitable purposes. Further, there will be no tax implication in subsequent years, as well.

3.05 *Query No. 5: Can the FD deposits be kept for a longer period than 12 months?*

Fixed deposits can be made for a longer tenure. It may further be understood that there will be no further capital gain at the time of liquidation of fixed deposits in subsequent years. Only the amount of additional interest accumulated shall be treated as income.

The organisation may opt for a longer tenure for the FDs or may renew the FDs at the end of 12 month, in both cases there will be no tax implications.

3.06 *Query No. 6 : Since the entire sales consideration was invested in FDs to avoid tax on capital gains, will the organisation be required to spend the entire amount in next 5 years?*

Once the sale proceeds is invested in another capital asset including FDs, then such amount can be retained indefinitely as corpus at the discretion of the organisation. There will be no legal requirement to spend such amount in future, however, the interest generated on FDs shall be treated as income subject to 85% application.

3.07 *Query No. 7: Is interest earned on our FDs added to the amount chargeable under capital gains tax or will it come under income tax regulations?*

The interest earned will be added to the respective years income subject to 85% utilisation.

3.08 *Query No. 8: If the entire capital gain is spent for charitable purposes then can the amount be spend on accrual basis? And what exactly counts as "spent"?*

It may be noted that for a charitable organisation availing exemptions under section 11 of the Income Tax Act, 1961 the word 'spent' means actual payment. In other words, to claim application the amount should have been actually paid, there is no concept of accrual or matching of expenditure. A charitable organisation can claim expenditure pertaining to past or future years if the payment is made during the financial year. The Finance Act, 2022 inserted the following Explanation after Section 11(7):

> *"Explanation.—For the purposes of this section, any sum payable by any trust or institution shall be considered as application of income in the*

previous year in which such sum is actually paid by it (irrespective of the previous year in which the liability to pay such sum was incurred by the trust or institution according to the method of accounting regularly employed by it):

Provided *that where during any previous year, any sum has been claimed to have been applied by the trust or institution, such sum shall not be allowed as application in any subsequent previous year."*

This Explanation explicitly provides that any sum payable by any trust shall be considered an application of income in the previous year in which such sum is actually paid. Thus, the application of income shall be allowed only on payment basis. This is irrespective of the previous year in which the liability to pay such sum was incurred by such trust according to the method of accounting regularly employed.

A proviso to the Explanation further provides that where any sum has been claimed to have been applied by such trust during any previous year, such sum shall not be allowed as an application in any subsequent previous year.

These amendments will take effect from 1st April, 2022 and will, accordingly, apply in relation to the assessment year 2022-23 and subsequent assessment years.

3.09 ***Query No. 9: Can the Capital Gain be treated as income and then accumulated for 5 years under Section 11(2)?***

Capital gains being available for application of income under section 11(1)(a), they should be entitled to accumulation for 5 years under section 11(2), but once they are accumulated under section 11(2), they have to be applied for the declared charitable or religious purposes for which they were set apart and accumulated. They will lose their separate identity as capital gains eligible for reinvestment into another capital asset. In *Trustees of Dr. Sheth's Charitable Trust* v. *Seventh ITO* [1982] 2 ITD 649 (Bom. - Trib.), the assessee was refused exemption when the unutilised capital gain was invested in another capital asset in the subsequent year. The Tribunal held that the assessee could have exercised the option under section 11(2). Since it failed to do so, the exemption on that portion of capital gain was lost.

In this case, it seems that the Tribunal was in favour of allowing the benefit of section 11(2), even for reinvestment in another capital asset, but the accumulation can only be made for specified charitable or religious objectives, in which the income is to be applied within the next five years. Since the investment in capital asset was towards the corpus of the organisation, it would not be possible to invest in capital assets out of accumulated income. The capital gains if they are made available for religious or charitable purposes and they are, subsequently, accumulated under section 11(2), then they along with other accumulated incomes have to be applied for religious or charitable purposes and not in the purchase of a capital asset.

3.10 *Query No. 10: Can the investment in another capital asset be made before the legal transfer if the advance money is received?*

Capital gain normally arises at the time of transfer and therefore, normally the reinvestment period should be made after the date of transfer. However, in case of charitable organisations, it is reasonable to reinvest in a new capital asset only after the consideration is received. Similarly, if the trust or NPO receives advance amount even prior to the transfer of the capital asset, the reinvestment can be done even prior to the sale of asset. In the case of *Trustees of Shri Ramnagar Trust No. 1* v. *Third ITO* [1985] 13 ITD 426 (Bom. - Trib.), the assessee had received the consideration in advance in the earlier assessment years and had re-invested in new capital asset in the earlier assessment year but claimed the benefits of section 11(1A) in the subsequent assessment year. The Bombay Tribunal held that the benefits under section 11(1A) were permissible.

In the case of Trustees of *Shri Ramnagar Trust No. 1* v. *Third ITO* [1985] 13 ITD 426 (Bom. - Trib.), it was held that advances received by a trust in the period prior to the previous year in which the transfer of a capital asset by a trust takes place, if invested in the purchase of a capital asset in the period earlier to the previous year, shall also be considered as an application of capital gains for charitable purpose.

3.11 *Query No. 11: Whether Section 50C applies to charitable trust?*

Trusts that are registered under section 12AA/12AB of the Income-tax Act, 1961 are governed by sections 11 to 13. As a result, the regular provisions under different heads of income do not apply to them. Consequently, Section 50C, which is a part of the provisions that deal with income from capital gain, is not relevant to trusts that are registered under section 12AA/12AB of the Income-tax Act, 1961.

Section 11(1A) cannot be substituted with section 50C. It has been specifically held that the provisions of section 50C are not applicable to charitable organisations registered under section 12AA. 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 the charitable organisation.

The other cases relevant in this regard are as under:

(a) Sri Guru Dattatreya Mattum v. Income Tax Officer (Exemptions) Ward Guntur, 2020 (3) Tmi 543 - Itat Visakhapatnam.

(b) DCIT v. Saife Jubilee High School (Ahmedabad ITAT ITA No. 2301/Ahd/ 2014) [2018 (11) TMI 540 – ITAT Ahmedabad]

(c) ACIT-1, Kanpur v. Upper India Chamber of Commerce ITA 601/LKW/2011 [2014 (11) TMI 395 - ITAT Lucknow]

(d) CIT v. Thiruvendgadam Investments Pvt. Ltd. 2009 (12) TMI 48 - Madras High Court.

The legal and judicial analysis in light of the judgment is provided as under.

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 are not attracted, because, for charitable organisations, a separate code *i.e.* section 11(1A) of the Act exists for taxation of capital gains. Further, ‘Net Consideration’ and ‘cost of the transferred asset’ for the purposes of section 11(1A) of the Income-tax Act, 1961 have been separately defined in the *Explanation* to the said section.

It is apparent from the above that though, the cost of transferred assets is computed as per the provisions of sections 48 and 49, the 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 the *Explanation* to this section.

Further, the provision of section 11(1A) is specific provisions, whereas provisions of section 50C are general provisions and 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.

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.

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.

Annexure 1

CBDT'S INSTRUCTION NO. : 883 DATED 24.9.1975

BOARD'S INSTRUCTION NO. 883 [XXI/1/74]

dated 24.9.1975

Sec. 11(1A) of the IT Act, 1961

Another capital asset — Scope of the expression

Sec. 11(1A) of the IT Act, 1961, provided that where a capital asset, being property held under trust wholly for charitable or religious purposes is transferred and the whole or any part of the net consideration is utilised 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 therein.

2. The Board had occasion to examine whether investment of the net consideration in fixed deposit with a bank would be regarded as utilisation of the amount of the net consideration for acquiring 'another capital asset' within the meaning of s. 11(1A) of the IT Act, 1961. **The Board has been advised that investment of the net consideration in fixed deposit with a bank for a period of six months or above would be regarded as utilisation of the net consideration for acquiring 'another capital asset' within the meaning of s. 11(1A) of the IT Act, 1961.**

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