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**Potential Tax Implications of Investment in Shares of a 'For Profit' Company by a Charitable Institution**

India has a large number of 'not for profit' institutions in the form of public charitable trusts, societies and Section 8 companies. These institutions are not only engaged in socio-economic development activities for poor and economically backward classes but are also involved in education and health care sectors and have set up successful educational institutions and hospitals across India. Many of these charitable institutions have hugely profitable balance sheets and want to invest in share capital of other companies. The moot question that arises is whether these tax-exempt charitable institutions are entitled to participate and invest in other 'for profit' companies and continue to avail their tax exemptions.

There is no specific restriction under Companies Act, 2013 ("CA13") that prohibits a Section 8 company to invest in shares of 'for profit' companies, however, Section 8 of CA13 does emphasis that this company should have the intent to apply its profits or other income in promoting its objects towards art, commerce, science, sports, education, charity etc. Similarly, societies and trusts are expected to engage in charitable activities stated in their main objects and application of their income is governed by their charter documents. In case the 'not for profit' tax exempt institutions do apply their income in acquisition of shares of 'for profit' companies, they will need to assess its implications not only under the terms of their charter documents (such as trust deed, memorandum of association, bye-laws) but also assess

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the implications of this investment under the Income Tax Act, 1961 (“IT Act”) to continue claim exemption from income tax.

Taxation of charitable institutions is governed by Chapter III of the IT Act. Section 11 and 12 of the IT Act contain the provisions and conditions to be fulfilled by the charitable institutions to avail exemption under section 11(1)(a) of the IT Act. Section 13 of the IT Act prescribes certain situations where the exemption under section 11 will not apply. As per Section 11 of the IT Act, in order to claim exemption of income derived from the property held under trust or on receipts from voluntary contributions, the charitable institution must apply the income for charitable purposes in India and in case such income is accumulated or set apart for application to charitable purpose, such accumulation is not in excess of 15% of the total income from such property. Charitable purpose has been defined under Section 2(15) of the IT Act, and includes relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility. It is important to note that the definition of “charitable purpose” is an inclusive definition and not exhaustive. Therefore, purpose(s) similar to those mentioned in the definition could also constitute charitable purpose under the IT Act.

In view of the foregoing, the exemption under Section 11 of the IT Act is confined to such portion of the income: (a) which is applied to charitable or religious purposes in India, or (b) which is accumulated for application to such purposes within the limits of accumulation permissible under Section 11(1) and (2) of the IT Act i.e., up to 15% of the total income from such property.

Sub-section 11(2) further relaxes the condition of application or deemed application of 85% of income during the relevant previous year if such income, accumulated or set apart, is invested or deposited in the form or mode specified in Sub-section 11(5) of the IT Act subject to compliance with certain conditions. Section 11(5) of the IT Act requires the accumulated funds to be invested or deposited in certain stipulated manner/mode including investment in government savings certificates, deposit in any account with the Post Office Savings Bank, investment in units of the Unit Trust of

India established under the Unit Trust of India Act, 1963, investment or deposit in any public sector company, investment in immovable property etc.

Section 13 of the IT Act provides for non-operation of Section 11 in case of certain incomes received by an entity registered under Section 12AA. In terms of Section 13(1)(d)(i) of the IT Act<sup>1</sup> (read with Section 164(2), income from any funds of the trust or institution invested in modes other than those specified under Section 11(5), will be subject to taxation at a maximum marginal rate as per the provisions of the IT Act. Thus, if the charitable institution receives any income from its investments made in a company (such as dividend), such income will be subject to tax as above.

Reference may be made to the order passed by Bombay High Court in Director of Income-Tax v. Sheth Mafatlal Gagalbhai [2001 249 ITR 533 Bom], wherein, the Bombay High Court observed that maximum marginal rate of tax will apply on the charitable entity to the dividend income from shares held in a company (i.e. only to that part of the income which has forfeited exemption under Section 13(1)(d) of the IT Act) and not to the entire income.

**Conclusion:**

Considering the scheme of taxation, utilization of funds by a charitable institution, for purchase of shares of “for profit” company, will not be deemed to be utilization of funds for charitable purpose and/or will not be in the acceptable mode or form stipulated under section 11(5) of the IT Act. Therefore, such utilization of funds towards acquisition of shares of a “for profit” company will not be an application of income, in accordance with Section 11 of the IT Act and will be liable to tax as per the provisions of the IT Act.

<sup>1</sup> “Section 13. (1) Nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof—

(a)...

(d) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof, if for any period during the previous year—

(i) any funds of the trust or institution are invested or deposited after the 28th day of February, 1983 otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11; or

...

(iii) any shares in a company, other than—

(A) shares in a public sector company;  
(B) shares prescribed as a form or mode of investment under clause (xii) of sub-section (5) of section 11,  
are held by the trust or institution after the 30th day of November, 1983:  
xxxxx”

**Feedback**

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