Research paper

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Sale of trust property.

Business Laws

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BRIEF HISTORY OF THE RESEARCH PAPER

1. BACKGROUND OF THE MATTER

A not-for-profit, public, charitable trust incorporated under provisions of trust law. In this paper we are hypothetically assuming that a trust was created for the purpose of propagating Indian culture (hereinafter referred to as "**Trust**").

The research paper comprises of whether trust property belonging to a non-profit trust can be sold, if yes what is the procedure. The paper also provides advice with respect to capital gain issues and indemnification rights, especially in situations where the property is sold at less than market value.

2. APPLICABLE LAWS

Generally, there are two types of trusts in India: private trusts and public trusts. The Indian Trusts Act, 1882 (the "**Trust Act**") governs the private trusts. Public trusts are classified into charitable and religious trusts. The Charitable and Religious Trusts Act, 1920, the Religious Endowments Act, 1863, the Charitable Endowments Act, 1890, the Societies Registration Act, 1860, and the Bombay Public Trust Act, 1950 are the relevant legislations for the recognition and enforceability of public trusts. Besides the aforesaid, the Opinion also comprises of interpretation of the Transfer of Property Act, 1882, Registration Act, 1908, Indian Contract Act, 1872, the Income Tax Act, 1961 (the "**Income Tax Act**") as amended from time to time and other ancillary legislations intertwined directly or indirectly with the above legislations.

3. CRITICAL QUESTIONS TO BE ANSWERED

a. Being a public charitable trust, can the trust property be sold? If yes, what is the procedure?
b. Being a public charitable trust, will the Trust be liable to pay capital gain tax on the sale of property?
c. Is it legal and correct for the Trust to sell trust property at below market price?

RESEARCH PAPER

1. DEFINITION OF PUBLIC AND CHARITABLE TRUST

As a well-known fact, charitable institutions usually undertake charitable activity in the form of relief of the poor, education, medical relief and advancement of any other object of general public utility. Charitable institutions as per the Income Tax Act, 1961 are allowed exemption from tax to the income of the said trusts. Rationale behind such exemption is that, such institutions not only help people, but also help relieve the burden of governments to help the poor to great extent. The most important condition for a trust to be for public charitable purpose is that the beneficiary should be of general public and none of the objects of the of association should benefit any private individuals and it should cater to all irrespective of caste, creed or religion. The expression 'charitable purpose' is defined under section 2 (15) of the Income Tax Act 1961 which includes, relief to the poor, education, medical relief, preservation of environment including water sheds, forest and wild life, preservation of monuments or places of historic interests and the advancement of any other object of general public utility.

2. BEING A PUBLIC CHARITABLE TRUST, CAN THE TRUST PROPERTY BE SOLD? IF YES, WHAT IS THE PROCEDURE, ESPECIALLY WHEN THE SAME IS BEING SOLD AT LESS THAN MARKET VALUE?

It is clear that the Trust was formed was for public and charitable purposes. The Trust by virtue of it being a non-profit entity also enjoys tax exemption on its income under provisions of the Income Tax Act. In the present situation, not only is the Trust property being sold to a third party, it being pertinent to note that it may even be sold at less than market value.

A similar situation arose in *R. Venugopala Naidu & Ors Vs Venkatarayulu Naidu Charities*[1] where trust property belonging to a charitable trust was sold at less than market value. In this

[1] 1990 AIR 444; 1989 SCR Supl. (1) 760; 1989 SCC Supl. (2) 356 JT 1989 (4) 262; 1989 SCALE (2) 902

case, the allegation by petitioner was that the negotiated price was about 20% (percentage twenty) of fair market value. The contention was that this being a charitable trust, its property must be zealously protected because large segment of the community has beneficial interest therein. Sale by private negotiations which is not visible to the public eye and may even give rise to public suspicion should not, therefore, be permitted unless there are special reasons to justify the same. Care must be taken to fix the reserve price after ascertaining the market value for safe-guarding the interest of the trust. Petitioners contented that the properties in question must be sold by public auction and giving wide publicity regarding the date, time and place of public auction, thereby opening it to all purchasers who wish to participate in the auction and compete with others for purchasing the property.

The legal position that emerged out of this was that in case of public and charitable trusts, protection of public rights is paramount. Such instances affect the entire body of persons who are interested in the trust. It is for the vindication of public rights and therefore it is imperative that trust properties are not improperly and fraudulently alienated, especially because the trust has been constituted to perform not only charities of a religious nature but also charities of a secular nature.

After hearing the above contentions, in his judgment, Justice Kuldep Singh stated; "*We would have normally remanded the case for decision on merits but in the facts and circumstances of this case we are satisfied that the value of the property which the trust got was not the market value. Property of religious and charitable endowments, institutions or trusts must be zealously protected because large segments of community has beneficial interest therein. Sale by private negotiations which is not visible to the public eye and may, even give rise to public suspicion should not, therefore, be permitted unless there are special reasons to justify the same. It was further held that care must be taken to fix the reserve price after ascertaining the market value for safeguarding the interest of the institution. We direct that the properties in question may be sold by public auction by giving wide publicity regarding the date, time and place of public auction.*"

In another case judgment, *Mohan Lall Seal Vs Kanak Lall Seal*[2], one Mutty Lall Seal, during his life time executed a deed of trust, dedicating all his properties for religious, charitable and benevolent activities. In this case high court of Kolkata categorically stated that in case of charitable or religious trusts, the trustees have an inherent obligation to act in the interest of the trust and its beneficiaries and / or in other words, in public interest. Public interest demands that any transfer or alienation of trust property should be completely transparent, fair and in public interest. The court further stated that, it was therefore expedient that all transfers of property held by religious or charitable trusts should be open. The transfer should be given sufficient publicity to fetch the best price.

From the above cited case judgments, one can conclude that the present Trust created for charitable purposes and for the benefit of general public irrespective of caste or religion, any sale of Trust property must be done by open public auction in order to fetch the best possible price and not by private negotiations. The trustees of the Trust run the risk of fraudulent liability should they decide to sell property at less than market value through private contract. It is therefore advisable that trustees of every public, non-profit, charitable trust follow guidelines mentioned in the above cited judgments in order to be compliant with law and avoid unforeseen liability.

3. BEING A PUBLIC CHARITABLE TRUST, WILL THE TRUST BE LIABLE TO PAY CAPITAL GAIN TAX ON THE SALE OF PROPERTY?

As we have understood from the above explanation that the said trust has been formed for charitable purposes and therefore as per the Income Tax Act also enjoys tax exemption on its income. In order to understand whether the Trust will be liable to pay capital gain tax on the sale of its property, it is pertinent to refer to Section 11 (1A) of the Income Tax Act.

Scope of Section 11 (1A) of Income Tax Act

Though capital gains are part of income, they will be treated as applied for charitable or religious purposes, thereby forgoing tax liability, only to the extent to which sale proceeds of property are utilized for acquiring a new capital asset. In effect, if the sale proceeds are not applied for acquiring another capital asset, trust will lose exemption on the property sold. The

[2] (2010) 1 WBLR (Cal) 128

Supreme Court in its judgment *vide (*1989) 176 ITR (St.) 236 (SC) stated that, "*In order avoid capital gain on the sale of trust property, the whole or part of the net consideration received must have been utilized for acquiring another capital asset*." 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, thereby forgoing tax liability on the sale proceed. However if 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, eligible for tax exemption.

Let us understand the above with the help of an example. Assuming the net sale consideration is Rs 5,00,000 of which the net amount of capital gains in Rs 1,00,000, which alone is invested in a capital asset. The trust will be entitled to exemption only of part of the capital gains to be calculated in the manner laid down in section 11 (1A) (a) (ii) of the Income Tax Act. *i.e*, in the same proportion as the amount reinvested bears to the net sale consideration. In the given example, the amount reinvested being Rs 1,00,000 out of Rs 5,00,000, the exemption will be available for 1/5th of Rs 1,00,000, *i.e* Rs 20,000. The net consideration for the purpose is not the net amount of capital gains after adjustment for cost, but only the net amount realizable on sale after deduction of expenditure on transfer.

Time limit for re-investment

Though there is no specific time limit prescribed under the Income Tax Act, explanation 11 (1) lays down some time limit for application of income. It should be assumed that the same time limit should be applicable for reinvestment for purpose of section 11 (1A) so that it should either be reinvested in the same year or within the first 6 (six) months of the next succeeding year.

5. CONCLUSION

5.1 After meticulously studying various provisions of law, court judgments, trust deed and other ancillary documents of the said trust it can be clearly deduced that:

5.1.1 The trust in question formed for public and charitable purposes must adhere to principal and procedure laid down in the above mentioned court judgments. Trustees have an inherent obligation to act in the interest of the trust and its beneficiaries and / or in other words, in public interest. Any transfer or alienation of the trust property should be completely transparent, fair and must be zealously protected because large segment of the community has beneficial interest therein. Sale by private negotiations which is not visible to the public eye and may, even give rise to public suspicion should not, therefore, be permitted unless there are special reasons to justify the same. Additionally, care must be taken to fix the reserve price after ascertaining the market value for safeguarding the interest of the institution. It is therefore advisable that the property in question be sold by public auction by giving wide publicity regarding the date, time and place of public auction.

5.1.2 Additionally, assuming the above procedure is meticulously followed by trustees of the Trust, sale proceeds from the sale of the property in question comprising of property belonging to the Trust will be subject to capital gain tax of an appropriate amount, as applicable on the date of transaction. It must be noted that capital gain will only be treated as applied for charitable or religious purposes to the extent to which sale proceeds are utilized for acquiring a new capital asset. Therefore care must be taken by trustees to fulfill obligations under the Income Tax Act in order to avoid non-compliance obligations or liability.