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## **Payments to persons under Section 13(3) – must be ‘reasonable’ and ‘commensurate’ to services rendered; does not result in complete denial of exemptions u/s 11/ 12: Delhi HC**

In the recent case of *ILLM Foundation*<sup>1</sup>, the Delhi HC has answered an important question regarding the interpretation and purport of Section 13 and its impact on the claim of exemption under Sections 11/12 of the Income Tax Act, 1961 (‘IT Act’).

### **Statutory Scheme:**

As per Sections 11 and 12, income of institutions/ trusts/ organization for “charitable purpose” are exempt from tax under the Act so long as the mandatory conditions under Sections 2(15)/ 12A of the IT Act are satisfied. Section 13 specifies certain prohibited instances of payments/ transactions; for e.g., Section 13(1)(c) provides that Sections 11/12 shall not exempt any income of the trust/ institution, which is applied directly or indirectly for the benefit of any person specified under Section 13(3) of the Act. Section 13(2), specifically clause (c) thereof, stipulates that income of the trust or institution shall be deemed to have been applied for the benefit of such person, *if any amount is paid by way of salary, allowance, etc. by the trust/ institution to such person and the amount so paid is in excess of what may be reasonably paid for such services.*

### **Brief Facts of the case:**

- (a) The Assessee, a trust registered under Section 12A, was engaged in imparting education;
- (b) The Assessee had, during the relevant years, paid salary to its Chairperson [i.e., a person covered under Section 13(3)];
- (c) The AO held the payment of salary to be excessive, and consequently, denied Assessee’s claim of exemption under Section 11/12;
- (d) In appeal before the HC, the fundamental issue canvassed by the Revenue was that, notwithstanding that the salary paid by the Assessee was ‘reasonable and commensurate with the services rendered’, *considering that the Assessee had, admittedly, made payments to a person specified under Section 13(3), the same would automatically disentitle the Assessee from the benefit of exemption under Sections 11/12 of the IT Act.* In support thereof, heavy reliance was placed on the decision of *Charanjiv Charitable Trust*<sup>2</sup>.

**Judgment by Delhi HC:** The High Court, negating the aforesaid contention, opined as follows:

- a. The reasonability of the salary paid, having not been contested by the Revenue, the argument seeking forfeiture of exemption of the Assessee under Sections 11/12 is without merit;

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<sup>1</sup> 2025:DHC:2745-DB

<sup>2</sup> *DIT(E) vs. Charanjiv Charitable Trust* 2014 SCC OnLine 7776

- b. By virtue of Section 13(2)(c), if any amount is paid as a salary or allowance to a person specified under Section 13(3), it shall be deemed that income for the trust has been applied for the benefit of such person for the purposes of Section 13(1)(c)/(d);
- c. Further, if any part of the income of a trust for charitable or religious purposes is diverted for the direct or indirect benefit of a person referred, then exemption under Sections 11/12 would not be available to the extent that the said income of a charitable or religious purposes is applied for the benefit of a person specified in sub-section (3) of Section 13;
- d. If, however, the person [referred to in Section 13(3)] has rendered any service for which the amount paid is such, that is, reasonably paid for such services, the same cannot be deemed to have been applied for the benefit of said person as per Section 13(1)(c)/(d); this is apparent, more so, from the plain language of Section 13(2)(c) of the IT Act which qualifies the act of payment of salary to ‘prohibited persons’<sup>3</sup> with the phrase “*in excess of what may be reasonably paid for such services*”;
- e. Lastly, the High Court noted that the observations made in the case of *Charanjiv Charitable Trust (supra)* must be read in the context of the facts of that case.

Accordingly, HC answered the questions of law in favour of Assessee and against Revenue.

The case was represented on behalf of the Respondent-Assessee by team of **VAISH ASSOCIATES ADVOCATES**, comprising of **Mr. Rohit Jain**, Senior Partner; **Mr. Aniket D. Agrawal**, Associate Partner and **Mr. Samarth Chaudhari**, Sr. Associate.

### VA Comments

The decision clarifies two major aspects – (1) *Firstly*, the IT Act does not make any absolute prohibition on payments by Charitable Institutions to (specified) persons, so long as such payments are reasonable and commensurate having regard to the services rendered by said persons; and (2) *Secondly and more importantly*, even in cases where payments have been made by the Charitable Institution to any of the (specified) persons, the same would not warrant forfeiture of entire exemption claimed under Sections 11/12 of the IT Act; **exemption would only be disallowed to the extent of payments made, which are in excessive and unreasonable.** Importantly, the High Court also clarified that the earlier decision in Charanjiv Charitable Trust (supra) cannot be construed to authorise complete withdrawal of exemption under Sections 11/12, in cases of violation of Section 13, and ought to be read in conjunction with the facts of that case.

On the latter aspect, section 13 was amended by the Finance Act, 2022, w.e.f. 1.04.2023 to specifically provide that exemption shall be denied to the extent of violation, thereby, clarifying the legal position from assessment year 2023-24 and onwards.

<sup>3</sup> As identified under Section 13(3) of the Act

**For any further information or clarification, please feel free to write to:**

**Mr. Rohit Jain, Senior Partner** ([rohit@vaishlaw.com](mailto:rohit@vaishlaw.com))

**Mr. Aniket D. Agrawal, Associate Partner** ([aniket.agrawal@vaishlaw.com](mailto:aniket.agrawal@vaishlaw.com))

**Mr. Samarth Chaudhari, Senior Associate** ([samarth@vaishlaw.com](mailto:samarth@vaishlaw.com))



Corporate, Tax and Business Advisory Law Firm

#### DELHI

1st, 9th, 11th Floor,  
Mohan Dev Building, 13, Tolstoy Marg,  
New Delhi, 110001 (India)

+91-11-42492525  
[delhi@vaishlaw.com](mailto:delhi@vaishlaw.com)

#### MUMBAI

106, Peninsula Centre,  
Dr. S.S. Rao Road, Parel,  
Mumbai, 400012 (India)

+91 22 42134101  
[mumbai@vaishlaw.com](mailto:mumbai@vaishlaw.com)

#### BENGALURU

105 -106, Raheja Chambers,  
#12, Museum Road,  
Bengaluru, 560001 (India)

+91 80 40903588/89  
[bangalore@vaishlaw.com](mailto:bangalore@vaishlaw.com)

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