INTER *face*

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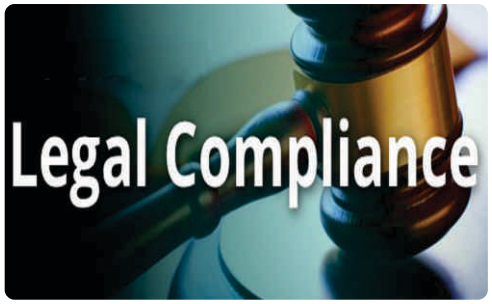
Highlights

- Budget – 2017 Changes with regard to NPOs
- Exemptions shall be withdrawn if IT Return not filed in time
- Accountability aspects of Fund Accounting
- CSR expenditure outside India
- Governance controls



A glimpse into the Father's heart

This is a story about a small boy who had the habit of coming home late from school. One day his parents warned him to be home on time, but he still came back late as usual. So they decided to teach him a lesson. At dinner that night, the boy was served only a slice of bread and a glass of water while his father had a full plate of food before him. The poor boy looked with hungry eyes at his father's full plate and with pleading eyes at his father. The father waited for the full impact to sink in, then quietly took the boy's plate and placed it in front of himself. He took his own full plate of food, put it in front of the boy, and smiled at his son. When that boy grew up, he said, "All my life I've known what God is like by what my father did that night." What his father did was take on himself the punishment and suffering that rightly belonged to his son. This is called atonement or substitutive suffering.

Acknowledgement

We are grateful to the authors who have contributed for the articles in this edition.

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1. CAN SALARIES BE PAID TO BOARD MEMBERS & TRUSTEES

INTRODUCTION

1.1.1 There is lack of clarity regarding remuneration or salaries of Board Members and Trustees of an NGO. There is a common misconception that remuneration or salaries cannot be paid to Board Members and Trustees of an NGO. At the outset, it is clarified that remuneration or salaries can be paid to the Board Members and the Trustees for the actual services rendered as a contractual obligation. The only precaution to be exercised is to ensure that no benefits are extended to the Board Members or the Trustees. A benefit means something which is not due to the recipient.

THE REASON FOR MISCONCEPTION REGARDING SALARIES TO TRUSTEES

1.2.1 The primary reason behind the misconception that remuneration or salaries cannot be paid to Board of Members and Trustees of an NGO is the provisions of Indian Trust Act 1882. Section 50 of this Act provides that Trustees cannot be paid remuneration. However, it may be noted that Indian Trust Act 1882 does not apply to public charitable or religious trust. The provision of Section 50 is provided as under:

"Trustee may not charge for services. 50. In the absence of express directions to the contrary contained in the instrument of trust or of a contract to the contrary entered into with the bene ficiary or the Court at the time of accepting the trust, a trustee has no right to remuneration for his trouble, skill and loss of time in executing the trust. Nothing in this section applies to any Official Trustee, Administrator General, Public curator, or person holding a certificate of administration."

To sum of, the Indian Trust Act 1882 shall not apply and reasonable remuneration can be paid to the Board Members and the Trustees.

CAN HIGH SALARIES BE PAID

1.3.1 We need to understand the quantum of remuneration which can be legally paid and shall not be treated as unreasonable. Let us take an illustration; Chairman of XX Society wants to take a monthly salary of Rs.5 lakhs from the society and the Chairman is devoting his full time for the society and his educational qualifications, experience and credentials are very high. Presently, the society is paying the highest salary of Rs. 2 lakhs per month to some senior employees. The society is registered under Section 12AA (it is the section under which NGOs get tax exemptions). Whether the society can pay a remuneration of Rs.5 lakhs per month to it's Chairman or not and its implications along with any citations and case laws? The above illustration is discussed as under.

LEGAL OVERVIEW

1.4.1 The law pertaining to remuneration or fees paid to Trustees or Board Members is very enabling and allows reasonable remuneration to the Trustees or the Board Members under Section 13(1)(c) read with Section 13(2)(c). An overview of the law and cases in this regard is provided in ***Annexure 1***.

1.4.2 Under Income Tax Act any contractual compensation against the services rendered is permissible, however any benefit paid / provided is not permissible. A benefit means something which is not due to a person. As per this understanding, any unreasonable payment over and above what is reasonably due shall be treated as a benefit. This principle will apply to all organizations availing Tax exemptions under the Income Tax Act, 1961. An organization registered under Section 12AA or 10(23C)(v) or (vi) shall also be subject to the same principles.

1.4.3 The second issue is whether considerably higher remuneration can be paid to the Chairman or the Managing Trustee over and above the highest paid employee of the organization. In such circumstances, the issue is whether such high remuneration can be justified as reasonable. Again, the available judicial precedence is in favour of the assessees where it has been held that (i) the onus will be on the revenue to establish that the salaries are unreasonable, (ii) the AO just cannot subjectively conclude that the salaries are unreasonable. The seniority and expertise of the Trustees may warrant such high remuneration. An overview of the law and cases in this regard is provided in ***Annexure 2***.

1.4.4 The Supreme Court in *CIT Vs Kamala Town Trust* [2005] 279 ITR 89 (All) held that Section 13 of the Act, carves out an exception to the general exemption granted under Sections 11 and 12 of the Act, to the income derived by a trust / charitable institution. The onus lies on the Revenue to bring on record cogent material / evidence to establish that the trust / charitable institution is hit by the provisions of Section 13.

WILL THE ENTIRE INCOME BE TAXED IF REMUNERATION IS FOUND UNREASONABLE

1.5.1 Further, we have to understand that if for some reason the remuneration paid is deemed to be unreasonable then the issue arises whether the entire income will be taxed or only the portion of unreasonable salary shall be subjected to tax. In this context, there is enough of judicial precedence to opine that the entire income cannot be taxed and only the portion of unreasonable salary shall be subjected to tax. An overview of the law and cases in this regard is provided in ***Annexure 3***.

CONCLUDING REMARKS

1.6.1 In our considered view, firstly, there is no bar in paying reasonable remuneration. However, there is no objective yardstick available to determine what is reasonable. There is scattered judicial precedence where very high salary to the Trustees have also been treated as reasonable. A salary of Rs. 5,00,000/- per month in today's context can be established as reasonable by drawing parallels from the salary of CEOs of various national level Charities and Educational Institutions. However, it will remain a subject matter of interpretations and therefore, allied controversies and disputes during the Income Tax Assessment cannot be ruled out. Therefore, it is recommended that the salaries of the Board Members and the Trustees should not be unduly high over and above the other employees of the organization, though legally there is no stated bar on the quantum of remuneration.

Annexure 1

REASONABLE REMUNERATION UNDER SECTION 13(1)(C) READ WITH SECTION 13(2)(C)

Under the Income Tax Act, any contractual compensation against services rendered is permissible, however any benefit paid / provided is not permissible. A benefit means something which is not due to a person. Under this understanding, any unreasonable over and above what is reasonably due shall be treated as a benefit. Forfeiture under section 13(1)(c) can be done only if any benefit is provided to the Board Members or interested Functionaries. Section 13(1)(c) does not prohibit payment of remuneration, it gets attracted if any benefit is provided to the interested person. If the Functionary is a salaried employee under an employment contract and therefore, is being paid salary which is a contractual obligation on the part of the Trust then such remuneration is permissible. There has to be a reason or cause of action to infer and conclude that any benefit was provided to the Functionary. A benefit implies payment of anything which is not legally due to a person, therefore, the salaries paid cannot be treated as a benefit. It may also be noted that payment of salary *per se* is not a benefit. To establish that some benefit was passed under section 13(1)(c), it will be incumbent on the AO to have reasons to believe that the remuneration was legally not due to the Employees/Functionaries. Once the legal eligibility of the trustees/ board members to receive salary as full time employee is not disputed, then the only option available is to see the reasonableness of the salaries under section 13(2)(c).

It has been held that even if there is some transaction involving the interested person, it is not sufficient to attract section 13, unless some benefit is proved by the revenue*, CIT v. Kamala Town Trust* [2005] 279 ITR 89 (All.). The Allahabad High Court has clearly stated that the onus lies on the revenue to bring on record, cogent material to establish that the Trust/ Charitable Institution is hit by the provisions of section 13.

In *DIT(Exemption)* v. *Parivar Seva Sansthan* [2002] 254 ITR 268 (Delhi), it was held that the revenue cannot infer benefit based on certain transactions relating to Functionaries and reasonable compensation was no bene-fit. In this case the issue of remuneration paid to the Trustee was also deliberated and it was held that reasonable compensation could not be considered as benefit under section 13(1)(c).

In the case of *CIT v. J.K. Charitable Trust* [1991] 59 Taxman 602 (All.), the Trust Deed of assessee-Trust empowered trustees to establish, equip and maintain industrial homes for teaching unemployed person arts like handicrafts and other home industries and to make provision for payment to them daily, weekly or monthly, such wages or remuneration as trustees may determine on basis of place, work or otherwise, it was held to be charitable in nature as advancement of any other public utility.

In *CIT v. Trustees of Dr. Divekar Charity Trust* [1977] 110 ITR 227, it was held that reasonable remuneration paid to the trustees for managing the property and other activities for the purposes of the trust was justified and was applicable towards the purposes of the trust. In this regard, the cases *DIT (Exemption) v. Wardha Charitable Trust* [2002] 120 Taxman 665 (Delhi) and *DIT v. Sikar Charitable Trust* [2002] 120 Taxman 886 (Delhi) are also relevant.

In the case of *Arvind Bhartiya Vidhyalya Samiti v. ACIT* [2008] 173 Taxman 119/115 TTJ 351 (Jaipur), the appellate Tribunal of Jaipur in similar circumstances held that charging of reasonable remuneration could not be considered as benefit passed to the interested person.

In view of the above facts and decided case laws, it is submitted that there is no violation of Sec. 13(1)(c) of the Income Tax Act, 1961.

In the case of *ADIT (Exemption) v. Manav Bharati Child Institute & Child Psychology* [2008] 20 SOT 517 (Delhi) it was held that there is no prohibition in Act to remunerate interested person but such remuneration should be commensurate with services rendered by them and so found, it cannot be said that provisions of section 13(1)(c) are attracted so as to deny benefit of exemption under sections 11 and 12.

In the case of *CIT v. 21st Society of Immaculate Conception* [2000] 241 ITR 193 (Mad.), the Assessing Officer found that the Nuns who were managing the society were donating back certain portion of their salary. It was inferred as since they were being paid more than their needs, section 13(1)(c) was attracted. The Madras High Court observed that the test of reasonableness is not whether the payment was more than their needs, but whether it was commensurate with the services rendered by them.

In the case *Deputy Director of Income-tax (Exemption)-III, Hyderabad v. Gideons International in India* [2016] 65 taxmann.com 95 (Hyderabad Trib.), it was held that where there was a failure by the Assessing Officer to indicate the assessment order that salary paid by the assessee-Society to the Executive Director was unreasonable, no violation of provision of section 13(1)(c) could be alleged and exemption could not be denied. It was held as under:

"As could be seen from the material placed on record, total salary paid in the initial year of appointment to the Executive Director*was Rs. 10.80 lakhs and not Rs. 7.20 lakhs as noted by the Assessing Officer. Therefore, compared to the salary paid in the initial year of appointment the salary paid in the year under consideration could not be excessive or unreasonable. The Assessing Officer has not mentioned any valid reason in the assessment order to indicate that the salary paid to the Executive Director is not commensurate with the responsibilities/duties performed by him. No material brought on record by the Assessing Officer to indicate that the salary paid is unreasonable or excessive."*

Annexure 2

HIGH SALARIES TO TRUSTEE SECTION 13(1)(C) READ WITH 40A(2)(A)

In the case of *Director of Income-tax (Exemption), Ahmedabad* v. *N.H. Kapadia Education Trust* [2012] 20 taxmann.com 702 (Ahd.) where the Managing Trustees were paid much higher in comparison to the Principal and other staff whose activities were confined to their rank while these Trustees had versatile experience, administrative and managerial skill and by their unstinted efforts and far-sightedness they were managing students, carrying on other administrative work, coordinating with Government agencies, higher payment made to them could not be doubted. It was further held that since these Trustees had to commute on day-to-day basis to various Government agencies, and other allied places which were scattered all the over vast city of Ahmedabad, this cannot be branded at any stretch of imagination that Trustees had been provided with excessive amenities such as vehicles etc.

In the case of *ACIT* v. *Idicula Trust Society* [2012] 21 taxmann.com 144 (Delhi - Trib.) it was held that Assessing Officer cannot subjectively conclude that the salaries paid are unreasonable without providing any sound basis or evidence and also cannot apply Section 40A(2)(a) which provides that an assessee incurs any expenditure in respect of which payment has been made or is to be made to any person referred to in clause (b) of this sub-section, and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable having regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is also considered by him to be excessive or unreasonable shall not be allowed as a deduction. Thus, under Section 40A(2)(a), if an assessee made payments for availing benefit, services or any facility from the person mentioned in sub-clause (b) of Section 40A(2) and similar type of benefit, service type of benefit, service or facility could be availed from the open market at a cheaper rate then the excess amount considered by the Assessing Officer is to be disallowed to the assessee out of his business expenditure. Now, the income of the assessee is not being computed as a business income. The Tribunal observed that the assessee was a Charitable Institution and its income should be computed under Sections 11, 12 and 13. Clause (b) of section 40A(2) provides six categories of assessee along with list of persons who could be associated with the assessee. In this clause, no reference is being made to an assessee, who is a Society or Trust and whose income is to be assessed as per Sections 11, 12 and 13. Because a similar mechanism has been provided there in Section 13(1)(ii) and 13(3), it appears that the Assessing Officer has made reference to this section unnecessarily. Some relevant extract is as under:

"A bare perusal of section 13(1)(c)(ii) would suggest that whatever has been stated in Sections 11 and 12 with regard to providing certain benefits to the assessee would not be available on the amounts which have been extended directly or indirectly for the benefit of any person referred to in sub-section (3) of Section 13, meaning thereby, if an assessee had extended any undue benefit to the person mentioned in sub-clause (3) of Section 13 then those amounts would not be considered as application of income for the purpose of fulfilment of objects of the society and benefit of sections 11 and 12 would not be available to the assessee on those amounts. Thus, Section 13(3)(1)(c)(ii) is analogous to Section 40A(2)(a) and Section 13(3) is an analogous to sub-clause (b) of Section 40A(2). The Commissioner (Appeals) has rightly observed that restriction is applicable to those amounts which have been applied directly or indirectly for the benefit of any person referred to in subsection (3). It will not lead to any conclusion that assessee would loose its charity status. In other words, if a small amount is to be disallowed that would not disqualify to enjoy the status of charity.

It is necessary to examine whether the assessee has extended any undue benefit directly or indirectly to the persons referred to in sub-section (3). As far as the salary paid to two persons 'T' and 'A' (Rs. 8,16,000 and Rs. 7,20,000) is concerned, it is found that a similar salary was paid in assessment years 2005-06 to 2007-08. In assessment years 200506 and 2006-07, Assessing Officer made the disallowance and the Tribunal has upheld the deletion of disallowance. Thus, the issue is squarely covered by the order of the Tribunal. As far as the salary paid to 'J' is concerned, the salary of Rs. 55,000 per month has been paid. Assessing Officer disallowed the salary to the extent of 2/3rd. The Commissioner (Appeals) has considered the order of the Tribunal in assessment years 2003-04 to 2006-07 wherein salary in the case of 'J' has been partly disallowed. It was brought to notice that in the assessment year 2007-08, the Assessing Officer has allowed the total salary paid to 'J' and the salary was of Rs. 55,000 per month. It is further found that in this year, Assessing Officer has independently not brought any evidence which can show how much salary a person having qualification equivalent to 'J' could fetch in the open market. What are the rates of salary paid by other institution to a person who is teaching as well as managing the school."

In the case of *Arvind Bhartiya Vidhyalya Samiti* v. *Assistant Commissioner of Income-tax, Circle-4,Jaipur* [2008] 173 Taxman 119 (Jp.)(Mag.) it was held that reasonable salary and rent paid to persons referred to in Section 13(3) shall be said to be a deemed application for benefit of such persons. In the case of *CIT, Faridabad* v. *Idicula Trust Society, Faridabad* [2014] 45 taxmann.com 158, the High Court of Punjab and Haryana held that where all members of assessee-trust were engaged in whole time management activities of Trust and as regular time teachers and were being paid salaries from earning of these schools and were not being paid any extra salary for management work, there was no violation of the provisions of Section 13(2)(c) and the assessee was entitled to benefit of exemption under section 1.

In the case *PNR Society for Relief & Rehabilitation of the Disabled Trust Vs. DDIT* (ITAT Ahmedabad), ITA No. 2729/Ahd/2010, Date of Order: 14/ 08/2014 the assessee was a charitable trust registered u/s. 12AA of the Act. The assessee trust paid remuneration of Rs 4,80,000/- to Shri Anantbhai K. Shah who was a full time Secretary and Trustee of the assessee trust. The Assessing Officer disallowed the deduction claimed for above payment on the ground that the services rendered by Shri Anantbhai K. Shah were a duty of him as a trustee and the remuneration paid to him being violative of provisions of Section 13(1)(c) and 13(3)(cc). The Assessing Officer also opined that remuneration of Rs 4,80,000/paid to said Shri Anantbhai K. Shah cannot be treated as application towards objects of the trust and therefore, he disallowed the entire amount of Rs 4,80,000/- and treated the same as taxable income in the hands of the assessee charitable trust. Authorized Representative of the assessee contended that in view of the provisions of Section 13(2)(c), no disallowance of remuneration paid to the trustee which is not more than the fair market value can be made, and therefore, the Revenue was not justified in making arbitrary disallowance. He also pointed out that similar remuneration was paid to the same trustee in earlier years also which was accepted and allowed by the Department. The Authorized Representative of the assessee submitted that Shri Anantbhai K. Shah was qualified in B.A. (Sp.) degree in Sociology passed in 1962 from Gujarat University which was the only specialized degree in field of sociology. He has vast experience of over 45 years in the field of social working and developing institutions in this field. He has been awarded with the following awards for his achievements and his noble services in the field of helping handicapped people particularly children:

- Rajiv Gandhi Manav Seva Award – 1998
- Felicitated by former Prime Minister of India Late Shri Morarji Desai
- Nagardas Doshi Smarak Nidhi Trust Award – 1997
- Alpalwala Award – 2007

He has been declared as “Man of the Year” – 2006 by “The Week”. The assessee trust is engaged in various activities for relief and rehabilitation of disabled persons such as prevention and early intervention, polio eradication, corrective surgery polio/cataract/cleft lip congenital heart defect, research, training course, workshop for artificial limbs, aids, technology transfer, physio-occupational therapy centre, AT &T Technological park centre etc. The Authorized Representative of the assessee further submitted that Shri Anantbhai K. Shah was a full time Secretary in the assessee trust. He was engaged full time in the activities of the trust. Therefore, by no stretch of imagination it can be held that annual remuneration of Rs 4,80,000/- paid to said Shri Anantbhai K. Shah was more than the fair market value of his services rendered to the assessee trust.

It was held that the revenue could not bring any material to controvert the submissions of the Authorized Representative of the assessee. We find that the total receipts of the assessee trust were to the tune of Rs.443.24 lakhs during the year under consideration and the activity undertaken by the assessee trust was to the tune of Rs. 469.87 lakhs. Thus, the remuneration of Rs. 4,80,000/- which is about 1% of the total value of activities of the trust for looking after which the same was paid, cannot be said to be excessive or unreasonable.

Further, we find that the Departmental Representative could not controvert the submissions of the assessee and the remuneration was permissible.

Annexure 3

WHETHER ENTIRE EXEMPTION WILL BE LOST FOR VIOLATION UNDER 13(1)(C)

In the case *ITO Vs. Virendra Singh Memorial Shiksha Samiti* [2009] 18 DTR (Trib.) 502 (Lucknow) allegations were made by the IT Department that the assessee-society was disentitled from getting exemption under section 10(23C), as some benefit was imparted to the Founder of the Trust. It was held that in the first place, there was no evidence that such benefit had been imparted to the Founder and secondly, even if it was so, such instances cannot be imported to deny the exemption under section 10(22) / 10(23C). It was further held that mere disallowance of certain expenses cannot become basis for denying exemption under Section 10(22) / 10(23C).

The aforesaid judgement will be equally applicable to the exemption under Section 11 of the Act. Therefore, it is clearly established that even if some benefit has been imparted to the Founder of the trust, such instance cannot disentitle the assessee from the benefit of exemption under Section 11 of the Act.

In the case *Arvind Bhartiya Vidhyalya Samiti Vs. ACIT* [2008] 115 TTJ 351 (Jp.) It was, inter alia, held in this case that even if there was some misutilization of the funds / mis-management by the Trustees, or minor discrepancies are there, these cannot disentitle the assessee from the exemption under Section 10(22) or Section 10(23C) of the Act. The aforesaid judgement will equally apply to the exemption under Section 11 of the Act. Therefore, even if there is some mis-utilization of the funds /mismanagement by the Trustees or there are minor discrepancies, these cannot disentitle the assessee from exemption under Section 11 of the Act.

In the case *Dy.CIT Vs. Cosmopolitan Education Society* [2000] 244 ITR 494 (Raj.) allegations were made against the society that there was misutilization or mis-management of the income / funds of the Trust and accordingly, the exemption under Section 10(22) of the Act was denied to the assessee. It was, inter alia, held that if there was any mis-utilization or mis-management of the income / funds of the society, action could be taken against the members of the society and the benefit under Section 10(22) could not be denied to the society. It was also held in this case that in view of the judgement of the Supreme Court, in the case of *Aditnar Educational Institution Vs Addl.CIT* [1997] 224 ITR 310 (SC), an overall view is to be taken without being hyper technical in granting exemption under Section 10(22) of the Act. The aforesaid judgement will equally apply to the exemption under Section 11 of the Act. Therefore, if there is some misutilization or mis-management of the income / funds, the exemption under Section 11 of the Act, cannot be denied to the assessee Trust. In view of the aforesaid legal precedents, it is clearly established that only the relevant income falling within the mischief of section 13(1)(c) / 13(1)(d) will lose the benefit of exemption under Section 11 of the Act and the balance of the total income of the trust will remain eligible for the benefit of exemption under Section 11 of the Act. In other words, violation of Section 13(1)(c) / 13(1)(d) cannot lead to denial of exemption under Section 11 of the Act, to the total income of the Trust.

V. In the present context, it is also significant to note that the burden of proof lies on the Revenue to prove that Section 13 applies in a case.

Adobe Photoshop Clip Image is to bid to be export- Contrary Case

The Kerala High Court, in the case of *Agappa Child Centre Vs CIT* [1997] 226 ITR 211 (Ker) provided a very contrary ruling which effectively has been nullified by preponderance of

judicial pronouncement throughout the country. In this case, the trust purchased a refrigerator for its own use. However, before the completion of the trust buildings, the trust kept the said refrigerator at the residence of the managing trustee of the trust. The ITO refused exemption to the trust under Section 11 of the Act, on the ground that use of refrigerator by the managing trustee was violation of the provisions of Section 13(2)(b) of the Act. The aforesaid conclusion of the Assessing Officer was upheld by the CIT(A), the Tribunal, as well as the High Court.

My aforesaid view has received support from the recent judgement of Karnataka High Court, in the case of *CIT Vs Fr.Mullers Charitable Institutions* [2014] 363 ITR 230 (Karn). It was held in this case that perusal of Section 13(1)(d) of the Act, makes it clear that it is only the income from such investment or deposit, which has been made in violation of Section 11(5) of the Act, that is liable to be taxed and violation of Section 13(1)(d) does not result in denial of exemption under Section 11 to the total income of the assessee trust. The aforesaid judgement of Karnataka High Court is based on the judgement of Bombay High Court, in the case of *DIT(E) Vs.Sheth Mafatlal Gagalbhai Foundation Trust* [2001] 249 ITR 533 (Bom).

In the present context, the provisions of Section 164, particularly Section 164(2) and proviso thereto, are also relevant. It may also be stated here that in view of the proviso to Section 164(2) and Circular No.387, dt.6.7.1984, issued by the CBDT, all the legal precedents applicable to the violations under Section 13(1)(d) of the Act, will equally apply to the violations under Section 13(1)(c) of the Act. Before proceeding to deal with the relevant legal precedents in support of the aforesaid stand, it would be appropriate to refer to the relevant provisions of Sections 13 and 164 of the Act, along with relevant Circular of the CBDT. The same are discussed as follows:

I. SECTIONS 13(1)(C), 13(1)(D) AND 13(2) OF THE ACT.

In the present context, the provisions of Sections 13(1)(c), 13(1)(d) and 13(2) of the Act, are relevant. The same are discussed as follows:

1. Provisions of sections 13(1)(c) of the Act

For the sake of ready reference, the relevant part of Section 13(1)(c) of the Act, is reproduced as follows:

"***13. Section 11 not to apply in certain cases.*** (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—

(c) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof—

(i) if such trust or institution has been created or established after the commencement of this Act and under the terms of the trust or the rules governing the institution, any part of such income enures, or

(ii) if any part of such income or any property of the trust or the institution (whenever created or established) is during the previous year used or applied, directly or indirectly for the benefit of any person referred to in sub-section (3) :"

From the aforesaid provisions of Section 13(1)(c)(ii), it may be seen that if any part of income or any property of the trust is applied directly or indirectly for the benefit of any trustee, etc, then the benefit of exemption under Section 11 of the Act, will not be available to the trust, in respect of such income.

2. Provisions of Section 13(1)(d) of the Act.

For the sake of ready reference, the relevant part of Section 13(1)(d) of the Act, is reproduced as follows:

"***13. Section 11 not to apply in certain cases.*** (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—

(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

(ii) any funds of the trust or institution invested or deposited before the 1st day of March, 1983 otherwise than in any one or more of the forms or modes specified in sub- section (5) of section 11 continue to remain so invested or deposited after the 30th day of November, 1983; 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:"

From the aforesaid provisions of Section 13(1)(d), it may be seen that if the conditions laid down there under are not fulfilled, then the trust will lose the benefit of exemption under Section 11 of the Act, in respect of income referred to therein.

3. Provisions of Section 13(2) of the Act.

In the present context, section 13(2) of the Act is also relevant. For the sake of ready reference, section 13(2) of the Act, is reproduced as follows:

"***13. Section 11 not to apply in certain cases.****(2) Without prejudice to the generality of the provisions of clause (c) and clause (d) of sub- section (1), the income or the property of the trust or institution or any part of such income or property shall, for the purposes of that clause, be deemed to have been used or applied for the benefit of a person referred to in sub-section (3),—*

(a) if any part of the income or property of the trust or institution is, or continues to be, lent to any person referred to in sub-section (3) for any period during the previous year without either adequate security or adequate interest or both;

(b) if any land, building or other property of the trust or institution is, or continues to be, made available for the use of any person referred to in sub-section (3), for any period during the previous year without charging adequate rent or other compensation;

(c) *if any amount is paid by way of salary, allowance or otherwise during the previous year to any person referred to in sub-section (3) out of the resources of the trust or institution for services rendered by that person to such trust or institution and the amount so paid is in excess of what may be reasonably paid for such services;*

(d) *if the services of the trust or institution are made available to any personreferred to in sub-section (3) during the previous year without adequate remuneration or other compensation*

(e) *if any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in sub-section (3) during the previous year for consideration which is more than adequate;*

(f) *if any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in sub-section (3) during the previous year for consideration which is less than adequate;*

(g) *if any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in sub-section (3): Provided that this clause shall not apply where the income, or the value of the property or, as the case may be, the aggregate of the income and the value of the property, so diverted does not exceed one thousand rupees;*

(h) *if any funds of the trust or institution are, or continue to remain, invested for any period during the previous year (not being a period before the 1st day of January, 1971), in any concern in which any person referred to in sub-section (3) has a substantial interest."*

From the aforesaid provisions of Section 13(2), it may be seen that in respect of various circumstances referred to in clauses (a) to (h) thereof, the income or property of the trust or institution or any part of such income or property shall, for the purposes of Section 13(1)(c) and 13(1)(d), be deemed to have been used or applied for the benefit of the trustee, etc. It clearly implies that Section 13(2) is nothing but an extension of Section 13(1)(c) / 13(1)(d).

II. SECTION 164(2) OF THE ACT.

In the present context, the provisions of Section 164(2) are also relevant, which are reproduced as follows:

"***164.Charge of tax where share of beneficiaries unknown.****(2) In the case of relevant income which is derived from property held under trust wholly for charitable or religious purposes, or which is of the nature referred to in sub-clause (iia) of clause (24) of Section 2 or which is of the nature referred to in sub-section (4A) of Section 11 tax shall be charged on so much of the relevant income as is not exempt under Section 11 or Section 12, as if the relevant income not so exempt were the income of an association of persons : Provided that in a case where the whole or any part of the relevant income is not exempt under Section 11 or Section 12 by virtue of the provisions contained in clause (c) or clause (d) of sub-section (1) of Section 13, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate."*

From the aforesaid provisions of Section 164(2), it may be seen that in the case of relevant income referred to therein, tax shall be charged on so much of the relevant income, as is not exempt under Section 11 or 12, as if the relevant income not so

exempt were the income of an association of persons (AOP). It clearly implies that only that part of the relevant income which is not exempt under Section 11 or Section 12 is brought to tax, as the income of an AOP and the balance of income of the charitable trust / institution, will remain exempt. Further, as per the proviso to Section 164(2), where the whole or any part of the relevant income is not exempt under Section 11 or Section 12, by virtue of the provisions of Section 13(1)(c) or Section 13(1)(d), tax shall be charged on the relevant income or part of relevant income, at the maximum marginal rate. In view of the aforesaid proviso to Section 164(2), the Courts have held that in case of violation of the conditions under Section 13(1)(c) or 13(1)(d) of the Act, only the relevant income or part of such relevant income is liable to be taxed at maximum marginal rate. It is also held that the violation of Section 13(1)(c) or 13(1)(d) does not result in denial of exemption under Section 11, in respect of the total income of the assessee. In other words, only the non-exempt income, in view of the provisions of Section 13(1)(c) / 13(1)(d) would fall in the tax-net and the other income of the charitable trust / institution would remain exempt under the provisions of Section 11 of the Act.

III. RELEVANT PART OF CIRCULAR NO.387, DT.6.7.1984 [152 ITR (ST) 1]

In the present context, paragraph 28 of Circular No.387, dt.6.7.1984, issued by the CBDT, under the heading "Levy of income-tax at maximum marginal rate in the case of charitable and religious trusts which forfeit tax exemption" is very relevant. For our purpose, paragraph 28.6 of the aforesaid Circular is relevant, which is reproduced as follows:

***"28.6** It may be noted that new sub-section (1A) inserted in section 161 of the IT Act, which provides for taxation of the entire income received by trusts at the maximum marginal rates is applicable only in the case of private trusts having profits and gains of business. So far as public charitable and religious trusts are concerned, their business profits are not exempt from tax, except in the cases falling under clause (a) or clause (b) of section 11(4A) of the IT Act. As the maximum marginal rate of tax under the new proviso to section 164(2) applies to the whole or a part of the relevant income of a charitable or religious trust which forfeits exemption by virtue of the provisions of the IT Act in regard to investment pattern or use of the trust property for the benefit of the settlor, etc., contained in section 13(1)(c) and (d) of that Act, the said rate will not apply to the business profits of such trusts which are otherwise chargeable to tax. In other words, where such a trust contravenes the provisions of section 13(1)(c) or (d) of the Act, the maximum marginal rate of income-tax will apply only to that part of the income which has forfeited exemption under the said provisions."*

As per the aforesaid paragraph 28.6 of the aforesaid Circular, where such a trust contravenes the provisions of Section 13(1)(c) or 13(1)(d) of the Act, the maximum marginal rate of income-tax will apply only to that part of income, which has forfeited exemption under the said provisions.

From the aforesaid discussion, it is clearly established that a legal precedent which applies in relation to violation of the provisions of Section 13(1)(d), will equally apply in relation to violation of the provisions of Section 13(1)(c), also.

IV. THE RELEVANT LEGAL PRECEDENTS

There are a number of legal precedents in support of the aforesaid stand, including the aforesaid judgements of Karnataka and Bombay High Courts. The same are discussed as follows:

1. *CIT Vs Fr. Mullers Charitable Institutions* [2014] 363 ITR 230 (Karn) In this case, the assessee, a charitable trust, for the AYs 2000-01 and 2001-02 claimed exemption under Section 11. The Assessing Officer noticed that the assessee had advanced a sum of Rs.30 lakhs during the AY 2000-01 and a sum of Rs.50 lakhs during the AY 2001-02, respectively, to a company which was running a Kannada daily. According to the Assessing Officer, advancing of such a huge amount was in violation of Section 11(5). Further, as per Section 13(1)(d), the trust shall not be entitled for exemption under Sections 11 and 12 of the Act. Accordingly, the Assessing Officer assessed the aforesaid advances to tax. However, the CIT was of the opinion that in view of violation of Section 11(5), the entire income of the trust ought to have been assessed, as the trust was not entitled to any exemption under Sections 11 and 12 of the Act and the CIT revised the order passed by the Assessing Officer.

On appeal, the Tribunal, after considering the matter in detail and on examining Sections 11, 12, 13(1)(d) and Section 164(2) of the Act, inter alia, held that the order passed by the CIT was contrary to section 164(2) of the Act and the entire income of the assessee could not be assessed.

On appeal by the Revenue before the High Court, one of the substantial question of law admitted was whether the Tribunal was correct in holding that when a part of income is held to be violative of the provisions of Section 13(1)(d), only to the said extent, maximum marginal rate of tax is to be levied and not for the whole income, more particularly when there was violation of the provisions of Section 11(5) of the Act.

It was held by the High Court that a reading of Section 13(1)(d) of the Act, makes it clear that it is only the income from such investment or deposit which has been made in violation of section 11(5) of the Act, that is liable to be taxed and that the violation of Section 13(1)(d) does not tantamount to denial of exemption under Section 11 to the total income of the assessee. Accordingly, the appeals of the IT Department were dismissed.

In the aforesaid case, the Karnataka High Court has placed reliance on the judgement of the Bombay High Court, in the case of *DIT(E) Vs Sheth Mafatlal Gagalbhai Foundation Trust* [2001] 249 ITR 533 (Bom). Besides, a reference has also been made to the judgement of Delhi High Court, in the case of *DIT(E) Vs Agrim Charan Foundation* [2002] 253 ITR 593 (Del). In this context, the following observations of the Hon. High Court, on page 238 of the Report are very relevant:

"We are in respectful agreement that the views expressed by the Bombay High Court as well as the Delhi High Court for violating Section 11(5) of the Act and the entire income of the Respondent trust cannot be assessed for the tax" [Emphasis added] Thus, it was made very clear that where the whole or part of the relevant income is not exempted under Section 11, by virtue of violation of Section 13(1)(d) of the Act, tax shall be levied on the relevant income or part of the relevant income, at the maximum marginal rate. However, violation of Section 13(1)(d) does not result in the denial of exemption under Section 11, to the total income of the assessee.

2. *DIT(E) Vs Sheth Mafatlal Gagalbhai Foundation Trust* [2001] 249 ITR 533 (Bom). In this case, according to the Assessing Officer, on account of violation of Section 11(5) of the Act, the assessee forfeited exemption under Section 11, in respect of its entire income, viz. dividend income plus interest income, whereas according to the assessee, they were entitled to claim exemption and they were entitled to continuance of exemption in respect of interest income, though they had forfeited the right to claim exemption vis-a-vis the dividend income, as the assesses continued to hold the shares in a non-Government company even after 31.3.1993.

On appeal, the CIT(A) came to the conclusion that the assessee was not entitled to the benefit of exemption under Section 11, in respect of the entire income.

On further appeal, the Tribunal came to the conclusion that in view of Section 164(1), the income receivable by the trust was the relevant income. That a portion of such relevant income only would suffer tax because of the violation of the condition of investment prescribed under Section 11(5). The Tribunal found that non-fulfilment of such condition could not deprive the trust of the exemption of its other income, which had been granted to it in the earlier years. Hence, the Tribunal allowed the appeal of the assessee.

Against the aforesaid judgement of the Tribunal, an appeal was filed by the Department before the High Court. The following question was raised before the Hon.High Court:

"Whether violation of section 11(5), r.w.s.13(1)(d), by the assessee trust attracts maximum marginal rate of tax on the entire income of the trust".

The Counsel of the IT Department contended that in view of section 164(2), the forfeiture of exemption for breach of section 11(5) would result in imposition of tax on the maximum marginal rate, as if the assessee was an association of persons (AOP). He further contended that the entire income of the Trust was liable to be charged to tax under maximum marginal rate, on the basis of such income accruing to an association of persons. On the other hand, the Counsel for the assessee contended that the requirement of investment for specified securities under section 11(5) results in an income to the trust which is receivable by the trustees and it is called relevant income under section 164(1). He further contended that a portion of such relevant income in the present case would suffer tax because the condition of investment as prescribed under section 11(5) had not been fulfilled. But nonfulfillment of such condition could not deprive the trust of the exemption of its other income, which had been granted in earlier years. He further contended that in this connection, the proviso to section 164(2) is very important. According to him, the Legislature has clearly contemplated that in a case where the whole or part of the relevant income is not exempt under section 11, by virtue of violation of section 13(1)(d), tax shall be charged on the relevant income or part of the relevant income at the maximum marginal rate. In this connection, he also relied upon Circular No.387, dt.6.7.1984, issued by the CBDT [152 ITR (St) 1]. It was held by the High Court that section 164(2) refers to the relevant income which is derived from property held under trust wholly for charitable or religious purposes.

If such income consists of severable portions, exempt as well as taxable, the portion which is exempt is to be left out and the portion which is not exempt is charged to tax as if it is the income of the association of persons.

Therefore, a proviso was inserted by the Finance Act, 1984, with effect from 1.4.1985, under which in cases where the whole or any part of the relevant income is not exempt under section 11 or section 12, because of the contravention of section 13(1)(d), then tax shall be charged on such income or part thereof, as the case may be, at the maximum marginal rate. **In other words, only non-exempt income portion would fall in the net of tax, as if it was the income of an association of persons.** It was further held by the High Court that as per proviso to section 164(2), it is, inter alia, laid down that in cases where the whole or part of the relevant income is not exempt by virtue of section 13(1)(d), tax shall be charged on the relevant income or part of the relevant income at the maximum marginal rate. The phrase "relevant income or part of relevant income" is required to be read in contradistinction to the phrase "whole income" under section 161(1A). This is only by way of comparison. Under section 161(1A) which begins with a non-obstante clause, it is provided that where any income in respect of which a person is liable as a representative assessee consists of profits of business, then tax shall be charged on the whole of the income, in respect of which such person is so liable at the maximum marginal rate. Therefore, reading the aforesaid two phrases show that the Legislature has clearly indicated its mind in the proviso to section 164(2), when it categorically refers to forfeiture of exemption for breach of section 13(1)(d), resulting in levy of maximum marginal rate of tax only to that part of income, which has forfeited exemption. It does not refer to the entire income being subjected to maximum marginal rate of tax. This interpretation is also supported by Circular No.387, dt.8.7.1984 [152 ITR (St)1]. It was also held that in law, there is a vital difference between eligibility for exemption and withdrawal of exemption / forfeiture of exemption for contravention of the provisions of law. These two concepts are different. They have different consequences. In the circumstances, it was held that there wasmerit in the contention of the assessee that in the present case, the maximum marginal rate of tax would apply only to the dividend income from shares in Mafatlal Industries Ltd and not to the entire income.

Accordingly, the aforesaid question was answered in the negative, that is, in favour of the assessee and against the Department. It is, therefore, clearly established that the Bombay High Court approved the judgement of the Tribunal to the effect that nonfulfillment of condition of investment prescribed under section 11(5) of the Act, could not deprive the trust of the exemption of its other income, which had been granted to it in the earlier years. In other words, it is clearly established that violation of section 13(1)(d) does not tantamount to denial of exemption under section 11 to the total income of the assessee.

3. *Jamsetji Tata Trust Vs JDIT (E)* [2014] 101 DTR (Trib) 305 (Mum)It was, inter alia, held in this case that violation of section 13(1)(d) and section 13(2)(h) deprives exemption only to the income from investments not permitted under section 11(5) and not to the entire income of the trust, if the other income of the trust, otherwise fulfils the condition for exemption. Therefore, the exemption under section 11 is available to the assessee only in respect of income, to the extent the same is derived in conformity to section 11 and applied during the year for the purposes of the trust. While reaching the aforesaid conclusion, the Hon. Tribunal has followed the judgement of Bombay High Court, in the case of *DIT(E) Vs Sheth Mafatlal. Gagalbhai Foundation Trust* [2001] 249 ITR 533 (Bom). It may also be stated here that in the aforesaid judgement, the Tribunal has also followed the earlier judgement of Mumbai Bench of the Tribunal, in the case of *Gurdayal Berlia Charitable Trust Vs ITO* [1990] 34 ITD 489 (Bom). It was held

in this judgement that non-fulfilment of the condition of investment under section 11(5) cannot deprive the trust of exemption of its other income, which has already been granted to it in the earlier years. The non-fulfilment of the condition under section 11(5) would only make a portion of the relevant income as specified under section 164(1), liable to tax. It was further held that in such a case, the provisions of section 164(2), along with the proviso thereto, would come into operation and only such income would be brought to tax at the maximum marginal rate, which cannot be treated as exempt by virtue of non-fulfilment of the condition of investment under section 11(5) of the Act.

4. *CIT Vs. Red Rose School* [2007] 163 Taxman 19 (All.) It was, inter alia, held in this case that the language used in section 12AA for the registration of a trust, only requires that activities of the trust or the institution must be genuine, which, accordingly, would mean that they are in consonance with the objects of the trust / institution and are not mere camouflage, but are real, pure and sincere and are not against the objects of the trust. The profit earning or misuse of the income derived by charitable institution from its charitable activities may be a ground for refusing exemption only with respect to that part of the income, but cannot be taken to be a synonym to the genuineness of the activities of the trust or institution [Paragraph 34 on pages 32 and 33 of the Report] It may, thus, be seen that as per the aforesaid judgement of the Allahabad High Court, the misuse of the income derived by the charitable institution from its charitable activities may be a ground for refusing exemption only with respect to that part of income and not the whole of the income of the trust / institution.

2. CAN NGOs HAVE ACTIVITIES OUTSIDE INDIA

INTRODUCTION AND THE LAW

2.1.1 Under the prevailing provisions of Income-Tax Act, 1961, income applied on activities outside India is not eligible for exemption unless the organisation was created before 1-4-1952 or it is engaged in the promotion of international welfare in which India is interested.

2.1.2 Central Board of Direct Taxes (CBDT) by general or special order can grant permission for carrying out such activities. An organisation can apply to the CBDT for permission to work outside India. The applications seeking approval u/s 11(1)(c) may be submitted in the office of Member(IT), Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, North Block, New Delhi.

2.1.3 Under the current law, any transfer of fund outside India is not permissible even if it benefits the beneficiaries in India.

2.1.4 There have been instances where the CBDT has formally invited applications for activities outside India. With regard to the Earthquake in Nepal, the Central Board of Direct Taxes had decided to fast track all applications made u/s 11(1)(c) of the Income Tax Act, 1961 seeking approval for rendering help to the victims of earthquake in Nepal. The CBDT had directed its Department to process these applications within two working days of receiving the completed applications. The documents to be attached are provided in Schedule 1.

2.1.5 All organisations should verify whether an enabling clause to work outside India is present in the Constitution/Trust Deed/ Memorandum of Association. In case the Constitution is silent about the area of operation, such organisation may work outside India by passing a special resolution provided there is no restrictive clause with regard to area of operation.

2.1.6 It may be noted that if an organisation incurs expenditure outside India in contravention of Section 11(1)(c), then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption and will be taxed.

WHETHER FINANCIAL SUPPORT TO INDIAN BENEFICIARIES INCURRED OUTSIDE INDIA PERMISSIBLE

2.2.1 Any amount paid to deserving beneficiary is permissible, even if such beneficiary remit the same amount to a foreign entity for availing education or capacity building. However, the Income Tax Law regarding activity outside India are complicated and contradicting judicial precedence exist.

2.2.2 In the case of Director of Income-Tax (Exemption) v. National Association of Software & Services Companies [2012] 21 taxmann.com 213 (Delhi) the High Court of Delhi held that the income of the Trust should not only be applied for charitable purposes, but also applied in India for such purposes.

2.2.3 In the case *CEO Clubs India v. Director of Income-tax* (Exemption) [2012] 25 taxmann.com 217 (Mum.) it was held that holding of conferences abroad would not make activities of the assessee being carried out outside India. The benefits of such conference will ultimately go to the assessee and its members. It cannot be said that the activities of the assessee were carried on outside India.However, in the light of the NASSCOM case (supra), this case ruling may be distinguishable.

2.2.4 In the case *Jamsetji Tata Trust v. Joint Director of Income-tax* (Exemption) Range-II [2014] 44 taxmann.com 447 (Mumbai - Trib.) with regard to investment in violation of Section 11(5) it was held that Education grant given to Indian students for studying abroad fulfils conditions of application of money in order to claim exemption under Section 11.

2.2.5 Further, the Charter for FC Registered Organisations issued by Home Ministry also provides that all FC grants should be applied in India only. **Kindly see Schedule 2.**

APPLICABILITY OF FCRA TO ACTIVITIES OUTSIDE INDIA

2.3.1 Foreign Contribution Act, 2010 (FCRA) is silent regarding expenditure to be incurred in foreign country or activity outside India. However, the Charter for NGOs provided by FCRA department specifically states that activities outside India cannot be conducted with FC Funds, the Charter for NGOs is provided in Schedule 2. Further, it specifically provides that if the funds are transferred to another NGO, it can be given only to another FC registered NGO. Therefore, it is advisable to seek permission from the FCRA Department to work outside India. FCRA Department may provide specific or general permission u/s. 50 of the Foreign Contribution Regulation Act, 2010 (FCRA). Once the exemption is received then only FC fund should be used for working in Nepal.

2.3.2 In order to have a formal transfer of funds and relief material from one country to another, it is advisable to obtain the necessary permission from the Consulate of that Country in India and also inquire about the local laws applicable for such activity.

SECTION 10(23C) IS SILENT ABOUT THE PLACE OF ACTIVITY

2.4.1 In India, NGOs can be registered under the Income Tax Act, both under Section 10(23C)(vi) and also under Section 12AA. NGOs of national importance are granted registration under Section 10(23C). It may be noted that unlike Section 11(1)(c), the third proviso to Section 10(23C)(vi) does not mention the words "in India" with regard to application of funds for charitable and religious purposes. Therefore, it raises the question whether NGOs registered under Section 10(23C) can have some activities outside India. The Supreme Court gave a landmark judgment in *American Hotel & Lodging Association Educational Institute v. CBDT* [2006] 206 CTR (Delhi) 601/ [2007] 289 ITR 46 (Delhi). In this case, the assessee NGO was a branch office of an American NGO. It was not doing any charitable activity in India and all its income in India was repatriated to USA.

2.4.2 The Supreme Court was of the opinion that exemption under Section 10(23C) will not be available if all the activities were outside India though Section 10(23C) does not specifically make it mandatory that the activities shall be done in India. In other words, the Supreme Court opined that the NGOs registered under Section 10(23C) should primarily have activities in India to claim exemptions. The Court observed that the absence of words "In India" does not automatically imply "anywhere in the world". In the light of this ruling, it may be concluded that NGOs registered under

Section 10(23C)(vi) are also required to have activities in India only; however, in the light of the observation of the Supreme Court they may have some activity outside India as there is no specific bar on working outside India under Section 10(23C)(vi).

2.4.3 Therefore, one needs to distinguish between an NGO registered under Section 12A and Section 10(23C), the former cannot have any activity outside India, without prior permission of CBDT, but the latter may have some activities outside India because Section 10(23C) is silent about the location of activities and the Supreme Court opined that such NGOs should primarily be working in India. Therefore, in either case, to avail tax exemptions in India, the dominant purpose and activity should remain inside India.

INCOME SHOULD NOT ONLY BE APPLIED FOR CHARITABLE PURPOSES BUT ALSO APPLIED IN INDIA

2.5.1 In the case of*Director of Income-tax (Exemption) v. National Association of Software & Services Companies* [2012] 21 taxmann.com 213 (Delhi) the High Court of Delhi held that the income of the Trust should not only be applied for charitable purposes, but also applied in India for such purposes. It was observed that the interpretation of the words 'in India' qualifies only the words 'such purposes' would not only be contrary to the plain grammatical meaning of Section 11(1)(a) but also render the provisions of Section 11(1)(c) redundant and otiose. If it was accepted that income of trust can be applied even outside India so long as the charitable purposes are in India, then there is no need for a trust which tends to promote international welfare in which India is interested and was created on or after 1-4-1952 to apply to the CBDT for a general or special order for exemption.

2.5.2 The High Court interpreted the natural grammatical meaning of the words "to the extent to which such income is applied to such purposes in India" appearing in Section 11(1)(a) of the Act. The High Court observed that the word "applied" is a verb in the past tense used in a transitive form followed by words "such purposes" and "India" qualified with two prepositions "to" and "in". This being the case, the words should be read as applicable to charitable purposes and also applied in India to such purposes.

2.5.3 The assessee's contention, that "in India" qualifies only the phrase "such purposes" so that only the purposes are geographically confined to India, was not acceptable to the High Court. The Court observed that if such meaning was assigned to the words, it would disturb the natural or grammatical interpretation of the words, "to the extent to which such income is applied to such purposes in India". For this purpose, the Court relied on a few rules of interpretation laid down in the cases of *Jugal Kishore Saraf v. Rao Cotton Co. Ltd.* AIR 1955 SC 376; *Kanai Lal Sur v. Paramnidhi Sadhukhan* AIR 1957 SC 907 and *Union of India v. Rajiv Kumar* [2003] 6 SCC 516.

The implication of this decision is that an expenditure cannot be made outside India, for example, an NGO cannot medically treat a person outside India or it cannot import medicine from outside India but can buy imported medicine from a dealer in India.

2.5.4 In the case *India Brand Equity Foundation v. Assistant Commissioner of Income-tax* (E), Trust Ward-II, New Delhi [2012] 23 taxmann.com 323 (Delhi) it was held that amount spent outside India for participating in a fair held outside India cannot be treated as application of income of trust for the purpose of Section 11(1)(a). The

ITAT observed that if the income of the trust can be applied even outside India so long as the charitable purposes are in India, then there is no need for a trust which tends to promote international welfare in which India is interested and which was created after 14-1952 to apply to the CBDT for a general or special order directing that the income to the extent to which it is applied in the promotion of international welfare outside India shall not be denied the exemption, nor would it be necessary for a charitable or religious trust created before the aforesaid date to seek such an order from CBDT in respect of its income which is applied to charitable or religious purposes outside India. Therefore, the words 'in India' appearing in Section 11(1)(a) and the words 'outside India' appearing in Section 11(1)(c) qualify the verb 'applied' appearing in these provisions and not the words 'such purposes'.

SUPPORTING STUDENTS TO STUDY OUTSIDE INDIA

2.6.1 In case of *Jamsetji Tata Trust v. Joint Director of Income-tax* (Exemption) Range-II [2014] 44 taxmann.com 447 Mumbai Tribunal held that education grant given to Indian students for studying abroad fulfils conditions of application of money in order to claim exemption under Section 11.

2.6.2 The Delhi High Court ruling in *DIT (Exemption) v. National Association of Software and Services Companies* [2012] 345 ITR 362/208 Taxman 178/21 taxmann.com 213 (Delhi) observed with regard to an example of supporting studies of students outside India wherein any payment made directly outside India was held as not permissible. It explained that the literal interpretation of the statute was not, probably, with the intent of the statute, with the following observations:

"He also pointed out by way of example an anomaly that is likely to arise because of the interpretation which we have placed upon the provision. He says that in the case of a Trust whose object is the giving away of scholarship; to meritorious student the cost of air tickets purchased in India and borne by the Trust to enable the student to go abroad for higher studies will be exempted from tax because the application of the income is in India, whereas the amount of fees paid by the trust abroad to the University there would not be exempt because it amounts to application of the income of the Trust outside India, even though there is no difference between the two so far, as the charitable nature of the purpose is concerned. In both the cases, according to him, the income is applied to the charitable purposes only.

28. What Mr. Vohra says is not without force or merit but we are required to interpret the statute as it is and not in the manner in which we think the law ought to be. We need to distance ourselves from matters of policy. Innovative thinking has its limits. Judicial adventurism, masquerading as judicial innovativeness should not rich we should feel chary of making forays. Secondly, we ought to be wise enough to know that in the matter of exemption from tax in all India statute, judicial restraint, and not innovativeness or novelty, may be the proper approach to follow in order that, the long settled legal position is not turned upside-down. We must, however, appreciate the tenacity with which the matter was argued before us by the learned-counsel on behalf of the assessee but we are afraid that he is looking up the wrong tree."

WILL ACTIVITIES OUTSIDE INDIA RESULT IN FORFEITURE OF ENTIRE INCOME?

2.7.1 It may be noted that if an NGO, registered under Section 12A incurs expenditure outside India in contravention of Section 11(1)(c), then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption. The provisions of Section 11(1)(c) do not attract forfeiture over the entire income unlike the provisions of Section 13(1). In other words, if an NGO is willing to pay taxes to the extent of its activities outside India, then to that extent it can have such activities. The total forfeiture of income is not possible because applying funds outside India has not been envisaged as a reason for forfeiture under Section 13(1)(a) to 13(1)(d). In the case of *CIT v. State Bank of India* [1988] 169 ITR 298 (Bom.) the trust had applied income outside India and the income to that extent only was subjected to tax.

2.7.2 If an organization incurs expenditure outside India in contravention of Section 11(1)(c), then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption. *CWT v. Trustees of the Nizam's Religious Endowment Trust* [1977] 108 ITR 229 (AP)

WILL A CLAUSE OF ACTIVITIES OUTSIDE INDIA IN THE TRUST DEED INVITE FORFEITURE?

2.8.1 If there is a clause in the trust deed which provides for activities outside India, it would not disentitle the organisation from claiming exemption. The provisions of Section 11(1)(c) are attracted only if actual expenditure is incurred outside India. Section 11(1)(c) cannot be invoked only on the ground that the trust deed provides for activities outside India.

2.8.2 In the case of *CIT v. State Bank of India* [1988] 169 ITR 298 (Bom.), one of the issues was whether a trust for charitable purposes in India and abroad can claim exemption from its income where the trustees have discretion to apply the income either in India or abroad. The Trust Deed provided, at the discretion of the trustees, to give 45 per cent of the income to the University of Athens. It was held that the trust was eligible for exemption even though it provided for application of income abroad. However, the portion of income actually applied abroad or accumulated for application abroad was not exempted.

2.8.3 Similarly, in *CWT v. Trustees of the Nizam's Religious Endowment Trust* [1977] 108 ITR 229 (AP), it was held that the charitable or religious expenditure incurred in India will not be affected by a provision for activities outside India or even actual expenditures abroad. Exemptions towards activities in India remain intact and in the case of a clause in the Trust Deed empowering the Trust to have activities outside India, there is no impact. And in the case of Trust having activities outside India, the exemptions will be denied to the extent of the income applied outside India.

2.8.4 Further it has been held that only the existence of other objects can not affect the charitable status of a Trust or NGOs in the case of *Digamber Jain Society for Child Welfare v. DGIT* (Exemptions) [2010] 228 CTR (Delhi) 517. In the case of *Ewing Christian College Society v. Chief CIT* [2009] 318 ITR 160 (All.), it was held that the objective to serve the church and nation would not mean that the society was not existing solely for educational purposes; therefore, any additional object clauses normally should not affect the charitable status of a trust or NGO.

2.8.5 In the case *Critical Art and Media Practices vs DGIT*(E), ITA No.736/ M/2013 decided in March 2015, it was held that if the objects permit activity outside India still the organization will remain charitable in nature and registration under *Sect*ion 12AA cannot be denied. Whether the assessee will be subjected to tax under *Secti*on 11(1)(c) for having activities outside India is another issue. In this case, the Ld. DIT(E) had rejected the application of the appellant trust observing that the trust deed of the appellant trust revealed that the appellant trust had charitable as well as non-charitable objects such as hosting of artists- in-residence programmes for international artists and raising funds for organizing trips, seminars and conferences within and outside the country etc.

TRANSFERRING FUNDS DIRECTLY TO A FOREIGN INSTITUTION FOR INDIAN BENEFICIARY

2.9.1 Under the current law, it is not advisable to transfer funds directly to the Foreign University or Institution, instead of paying to an Indian beneficiary. It is advisable to seek a one-time permission from CBDT for such transfer.

Annexure 1

DOCUMENT REQUIRED TO BE FURNISHED WHILE SEEKING EXEMPTION U/S 11(1)(C) OF THE INCOME-TAX ACT, 1961

1. Certified Copies of Trust Deed, Articles of Association, Memorandum of Association (as applicable) and PAN Card
2. Copy of order granting registration u/s 12AA of the Income Tax Act
3. Amount in INR and year in which it is proposed to be remitted/ incurred
4. In case money is to be remitted, a note on the purpose for remitting the money giving the details of remittee and the manner in which the sum remitted is generally proposed to be utilized
5. Copies of the latest IT Return along with Account Statements
6. Copy of the latest Assessment orders, if any in last five years
7. Details of pending prosecution launched by Income Tax Department, if any
8. Details of any proceeding initiated/pending for violation of FCRA regulations, if any

The applicant may give his e-mail id, phone number, fax number and complete address for correspondence.

The applications seeking approval u/s 11(1)(c) may be submitted in the office of Member(IT), Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, North Block, New Delhi.

Annexure 2

CHARTER FOR ASSOCIATIONS WHO HAVE BEEN GRANTED PRIOR PERMISSION OR REGISTRATION UNDER FCRA

- An association granted prior permission or registration under the repealed Foreign Contribution (Regulation) Act, 1976 shall be deemed to have been registered or granted prior permission, as the case may be, under the Foreign Contribution (Regulation) Act, 2010 (FCRA, 2010) and such registration shall be valid for a period of 5 years from the 1st May, 2011, i.e., up to the 30th April, 2016.
- Every certificate of registration granted under FCRA, 2010 shall be valid for a period of five years from the date of its issue.
- Every certificate of registration shall have to be renewed. The application for renewal is to be made in Form FC-5 along with the prescribed fee, six months before the date of expiry of the certificate of registration. An association implementing an ongoing multiyear project shall apply for renewal twelve months before the date of expiry of the certificate of registration. In case no application for renewal of registration is received or such application is not accompanied by the requisite fee, the validity of the certificate of registration shall be deemed to have ceased from the date of completion of the period of five years from the date of the grant of registration.
- An association granted prior permission or registration under the Foreign Contribution (Regulation) Act, 2010 (FCRA, 2010) should receive the foreign contribution in the same exclusive designated Bank Account mentioned in the order granting prior permission or registration. This account number would be the same as has been intimated by the organisation in their application for prior permission/registration. Deposit of any local fund in this bank account is not allowed. One or more accounts in one or more scheduled banks may be opened for utilizing the foreign contribution provided that no funds other than foreign contribution shall be received or deposited in such account or accounts. Section 17 of the FCRA, 2010 may please be referred.
- Foreign contribution cannot be mixed with local funds being handled by the organisation.
- An association granted prior permission or registration is required to carry out the activities, for which foreign contribution is received, in India only and the amount should not be utilised for purposes other than for which it is received.
- Any fixed asset acquired out of the foreign contribution and any article received in kind from the foreign source should be in the name of the association and not in the name of any individual in the association.
- Not more than 50% of the foreign contribution shall be defrayed to meet administrative expenses of the association. What constitutes 'administrative expenses' has been defined in Rule 5 of the Foreign Contribution (Regulation) Rules, 2011 (FCRR, 2011).
- Any foreign contribution or any income arising out of it shall not be used for speculative business. What constitutes 'speculative business' has been defined in Rule 4 of FCRR, 2011.
- An association granted prior permission or registration should maintain a separate set of accounts and records, exclusively for foreign contribution received and utilised.

If the foreign contribution relates only to articles, the intimation shall be submitted in Form FC-7. If the foreign contribution relates to foreign securities, theintimation shall be submitted in Form FC-8. Every report submitted shall be duly certified by a chartered accountant.

- Every account giving details of the receipt and purpose-wise utilisation of the FC, including the interest earned on the FC amount, should be maintained on an yearly basis, commencing on the 1st day of April each year, and every such yearly account is to be submitted, in prescribed Form FC – 6 along with the income and expenditure statement, balance sheet and statement of receipt and payment, duly certified by a chartered accountant in duplicate, within nine months of the closure of the year, i.e., before 31st December. Every such return in Form FC-6 shall also be accompanied by a copy of a statement of account from the bank where the exclusive foreign contribution account is maintained by the person, duly certified by an officer of such bank. The cash book and ledger account on double entry basis, where the FC relates to currency received and utilised. The annual return in Form FC-6 shall reflect the foreign contribution received in the exclusive bank account and include the details in respect of the funds transferred to other bank accounts for utilisation.
- The accounting statements shall have to be preserved by the NGO/ association for a period of six years.
- Even if no FC is received during a year, a 'Nil' return is required to be filed with the Ministry of Home Affairs within the prescribed time limit.
- Associations/NGOs granted registration or prior permission, which have received foreign contribution in excess of one crore rupees, or equivalent thereto, in a financial year, shall place the summary data on receipts and utilisation of the foreign contribution pertaining to the year of receipt as well as for one year thereafter in the public domain.
- No FC should be transferred to an association which has not obtained either prior permission or registration under FCRA or to any person or association, prohibited under FCRA from receiving any FC. However, if the foreign contribution is proposed to be transferred to a person who has not been granted a certificate of registration or prior permission by the Central Government, the person concerned may apply for permission to the Central Government to transfer a part of the foreign contribution, not exceeding ten per cent, of the total value of the foreign contribution received. The application shall be countersigned by the District Magistrate having jurisdiction in the place where the transferred funds are sought to be utilized. The District Magistrate concerned shall take an appropriate decision in the matter within sixty days of the receipt of such request from the person. The donor shall not transfer any foreign contribution until the Central Government has approved the transfer. Any transfer of foreign contribution shall be reflected in the returns in Form FC-6 as well as in Form FC-10 by the transferor and the recipient.
- Change of name, address, registration, nature of activities or aims and objectives of an association should be intimated to the Ministry of Home Affairs within 30 days of effecting the change, along with the documentary evidence effecting the change.
- Prior permission of Ministry of Home Affairs should be obtained for replacing 50% or more of the office bearers.
- Prior permission of Ministry of Home Affairs should be obtained for changing bank account for valid and convincing reasons.

3. CORPUS DONATIONS ANALYSIS OF RECENT AMENDMENTS 2017

INTRODUCTION

3.1.1 The Finance Act 2017 has amended Section 11 of the Income Tax Act and also inserted a new proviso to Section 10(23C). It may be noted that these two sections provide the conditions under which the income of a charitable organisation is exempted from tax. The amendments provide that any exempt Trust or NGO availing benefit of tax exemption under Section 11 or 10(23C) shall not, in future, be allowed to treat Corpus Donations given to another charitable organisation as application of income. As of now, both type of donations i.e. Corpus and General Donations by one charitable organisation to another have been treated as application of income.

3.1.2 The purpose of this amendment seems to curb the misuse of benefits available under Section 11. Under the current law all the exempted charitable institutions are required to apply 85% of their income, for charitable purposes, in the same year. Further, a corpus donation to another organisation is also treated as application of income and therefore, some organisations in order to comply with the requirement of 85% application of their income transfer certain part of their income as corpus donation to another NGO. The organisation which receives corpus donation is not required to apply 85% of its corpus income and as a result the recipient organisations can get away with the entire amount not being applied.

3.1.3 The intent of the amendment is to prevent the misuse of the benefits available under Section 11 but it raises many other technical issues which are discussed here under.

AMENDMENTS PERTAINING TO INTER CHARITY CORPUS DONATIONS

3.2.1 The following proviso has been inserted after the eleventh proviso to Section 10(23C), with effect from the 1st day of April, 2018, namely:

"Provided also that any amount credited or paid out of income of any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub clause (vi) or sub-clause (via), to any trust or institution registered under section 12AA, being voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution, shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or other medical institution, as the case may be, is established:";

3.2.2 A similar corresponding explanation has been added to Section 11(1)(d). The above amendments have been brought in with an intent to provide restriction in respect of any amount credited or paid out of income, being voluntary contributions with specific direction that they shall form part of the corpus, to any trust or institution registered under Section 12AA by not treating the said contribution as application

of income to the objects of such entities. This amendment will take effect from 1st April, 2018 and will, accordingly, apply in relation to the assessment year 2018-2019 and subsequent years.

RATIONALE AND CONTROVERSY PERTAINING TO DONATIONS

3.3.1 The proposed amendments will resolve certain existing controversies as under:

– There has been considerable amount of confusion regarding the Accounting and Tax treatment of Corpus Donation. Under the current law, inter charity donation is treated at par with direct utilisation of funds. Therefore, any donation including Corpus Donation was treated as application of income at the hands of the donor organisation. However, the controversy arises when such Corpus Donation is not treated as income in the books of the recipient charitable organisation. In other words, it was a loophole in the law and with the help of this, a charitable organisation can continue to remain exempt and compliant without applying the required 85% of income. For example, ABC is a charitable organisation and its income is Rs. 1 crore. It will have to apply at least Rs. 85 Lakhs under Section 11(1). However, if it makes a Corpus Donation of Rs. 85 Lakhs to another charitable organisation called XYZ, then it will be treated as application in the books of ABC and it will not be treated as income in the books of XYZ. The proposed amendment will plug this anomaly and will curb misuse of the Income Tax exemptions through rotation of funds.

– The amendment in Section 80G(5D) is technical in nature where the existing limit of cash donation has been reduced to Rs. 2,000/- from Rs.10,000/-. In principle cash transaction had already been controlled under Section 80G earlier and now by further reduction of the limit to Rs. 2,000/- it will bring greater transparency. It may further be noted that the limit of Rs. 2,000/- will be for a donor for the entire year. In other words, multiple receipts of Rs. 2,000/- in cash from the same person will not be permissible.

KEY ISSUES ARISING OUT OF PROPOSED CHANGES IN THE TREATMENT OF CORPUS FUND AS PER BUDGET, 2017

3.4.1 Basis for bringing change as explained in the budget document:

The change purportedly has been brought as an anti-abuse measure, as the department is of the opinion that a trust registered u/s. 10(23C) or 12AA makes donations towards corpus and considers it as application whereas for the donee trust, income through corpus is exempted and therefore, there is no requirement of application. Therefore, the trusts are engaged in giving corpus donation without application. However, there are many far reaching implications and ambiguities which have to be understood as under:

Impact of above changes for organisation claiming exemption u/s. 10(23C):

– As per the proposed modification, the corpus donation given by 10(23C) registered organisation to 12AA registered entity will not be considered as application of income, though no such restriction is proposed to be provided for making corpus donation by a 10(23C) registered entity to 10(23C) registered entities.

– Moreover, if the basic presumption of proposing such a change is that corpus donation encourages the practice of claiming exemption without application,

then this does not apply to an organisation registered u/s. 10(23C), as donation towards corpus of these entities are not exempt and form part of income subject to application.

Impact on the NGOs registered u/s. 12AA :

– 12AA registered trusts making donation towards corpus to an exempt entity u/s 12AA or 10(23C) cannot claim the same as application of income.

– However, the proposed modification has no impact if the corpus donation is given out of accumulated funds and is not considered as application of income, meaning thereby there is no blanket restriction on corpus donation.

Technical issues arising out of above modification:

While restricting application of corpus donation for 10(23C) trust entities, the words used are "being voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution" whereas while putting restrictions to 12AA entities the word "voluntary" is not mentioned and it indicates as "being contribution with a specific direction that they shall form part of the corpus of the trust or institution."

By omitting the word "voluntary" in one place indicates that corpus donation can be of two types – one is voluntary contribution with the specific direction and second restricted contribution with specific direction. Normally a corpus donation is voluntary in nature otherwise it would become an endowment grant if any specific condition is attached to it.

IMPACT AND LIMITATIONS OF THE AMENDMENTS PERTAINING TO DONATIONS

3.5.1 The proposed amendments are positive in nature; however, the issue pertaining to Corpus Donation could have been handled in a more holistic manner.

3.5.2 The corpus donation claimed as application of income should have been denied for both types of organisation i.e. one registered under 12AA and the other registered under Section 10(23C). Now, this amendment provides an undue and unreasonable advantage to organisations registered under Section 10(23C).

3.5.3 Further, distinction should have been drawn between long term grant provided for specific activities and unconditional corpus donation. Because only unconditional corpus donation could be disallowed as application. For instance, under CSR (Corporate Social Responsibility), Corpus Donation for specific project purposes are also permissible which are actually restricted project grants. There is a distinct difference between a Corpus Donation and restricted grant for specific purposes. In case of a Corpus Donation, no conditions for utilisation are attached. The only direction is to retain the funds in the Corpus of the organisation and the income thereof, can be spent for any purpose. However, if a long term fund is given for any specific purpose, then the fund and its income has to be used for such purposes only and such grant will continue to be treated as application. However, it would have been ideal, if such clarity and distinction was provided in the amended provisions.

4. BUDGET – 2017 CHANGES WITH REGARD TO NPOs

MAJOR CHANGES

4.1.1 The Finance Bill 2017 has amended Section 11 of the Income Tax Act and also inserted a new proviso to Section 10(23C). It may be noted that these two sections provide the conditions under which the income of a charitable organisation is exempted from tax. The proposed amendments provide that any exempt Trust or NGO availing benefit of tax exemption under Section 11 or 10(23C) shall not, in future, be allowed to treat Corpus Donations given to another charitable organisation as in application of income. Hitherto, both type of donations i.e. Corpus and General Donations by one charitable organisation to another have been treated as application of income.

4.1.2 The Finance Bill 2017 has also further amended the Section 80G(5D) of the Income Tax Act. By virtue of the amended provisions, NGOs cannot receive more than Rs. 2,000/- thousand rupees in cash for the purposes of 80G. The current limit is Rs. 10,000/-. In other words, any person donating more than Rs. 2,000/- in cash to a charitable organisation shall not be eligible for the benefits under Section 80G.

4.1.3 The Finance Bill 2017 has amended the Section 12A and 12AA of the Income Tax Act. It may be noted that Section 12A and 12AA are the sections under which a charitable organisation applies for registration for Income Tax exemption. The proposed amendments provide that any organisation availing benefit of tax exemption under Section 11 should be subjected to the following additional conditions (i) the organisation should inform the Commissioner of Income Tax within 30 days if there is any change in the object clause which changes the character of the organisation (ii) the organisation should file Income Tax returns under Section 139(4A).

4.1.4 There are considerable changes with regard to the filing of Income Tax return. The amendments are as under:

- Fee of Rs 5,000/- under Section 234F will be levied, if the income tax return is filed after 30th September but before 31st December and Rs 10,000/- if filed after 31st December. **However, the penalty of Rs. 5,000/- and Rs. 10,000/- will be reduced to Rs. 1,000/-, if the taxable income is less than Rs. 5 lakh. In other words, in case of NGOs, normally, the penalty for late filing will be Rs. 1,000/- only because the taxable income is generally Nil.**
- The option of filing revised of income tax return is now allowed only till the end of the assessment year. In other words, if the last date of filing income tax return is 30th September, 2017 then such return can be revised only before 31st March, 2018.

AMENDMENTS PERTAINING TO INTER CHARITY CORPUS DONATIONS

4.2.1 The following proviso has been inserted after the eleventh proviso to Section 10(23C), with effect from the 1st day of April, 2018, namely: —

"Provided also that any amount credited or paid out of income of any fund or trust or institution or any university or other educational institution or any hospital or other

medical institution referred to in sub-clause (iv) or sub-clause (v) or sub clause (vi) or sub-clause (via), to any trust or institution registered under section 12AA, being voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution, shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or other medical institution, as the case may be, is established:";

4.2.2 A similar corresponding explanation has been added to Section 11(1)(d). The above amendments have been brought in with an intent to provide restriction with respect to any amount credited or paid out of income, being voluntary contributions with specific direction that they shall form part of the corpus, to any trust or institution registered under Section 12AA by not treating the said contribution as application of income to the objects of such entities. This amendment will take effect from 1st April, 2018 and will, accordingly, apply in relation to the assessment year 2018-2019 and subsequent years.

RATIONALE AND CONTROVERSY PERTAINING TO DONATIONS

4.3.1 The proposed amendments will resolve certain existing controversies as under:

- There has been considerable amount of confusion with regard to the Accounting and Tax treatment of Corpus Donation. Under the current law, inter charity donation is treated at par with direct utilisation of funds. Therefore, any donation including Corpus Donation was treated as application of income in the hands of the donor organisation. However, the controversy arises when such Corpus Donation are not treated as income in the books of the recipient charitable organisation. In other words, it was a loophole in law with the help of which a charitable organisation can continue to remain exempt and compliant without spending the required 85% of income. For example, ABC is a charitable organisation and its income is Rs. 1 crore. It will have to spend at least Rs. 85 Lakhs under Section 11(1). However, if it makes a Corpus Donation of Rs. 85 Lakhs to another charitable organisation called XYZ, then it will be treated as application in the books of ABC and it will not be treated as income in the books of XYZ. The proposed amendment will plug this anomaly and will curb misuse of the Income Tax exemptions through rotation of funds.
- The amendment in Section 80G(5D) is technical in nature where the existing limit of cash donation has been reduced to Rs. 2,000/- from Rs.10,000/-. In principle cash transaction had already been controlled under Section 80G earlier and now by further reduction of the limit to Rs. 2,000/- it will bring greater transparency. It may further be noted that the limit of Rs. 2,000/- will be for a donor for the entire year. In other words, multiple receipts of Rs. 2,000/- in cash from the same person will not be permissible.

IMPACT AND LIMITATIONS OF THE AMENDMENTS PERTAINING TO DONATIONS

4.4.1 The proposed amendments are positive in nature; however, the issue pertaining to Corpus Donation could have been handled in a more holistic manner. For instance, under CSR (Corporate Social Responsibility), Corpus Donation for specific project purposes are also permissible which are actually restricted project grants. There is a distinct difference between a Corpus Donation and restricted grant for specific purposes. In case of a Corpus Donation no conditions for utilisation are attached.

The only direction is to retain the funds in the Corpus of the organisation and the income thereof can be spent for any purpose. However, if a long term fund is given for any specific purpose, then the fund and its income has to be used for such purposes only. It would have been ideal, if such clarity and distinction was provided in the amended provisions.

AMENDMENTS PERTAINING TO 12AA REGISTRATIONS

4.5.1 Clause 9 of the Bill seeks to amend Section 12A of the Income-tax Act relating to conditions for applicability of Sections 11 and 12. It is proposed to insert a new clause (ab) in sub-section (1) of said section so as to provide another condition for applicability of Sections 11 and 12. Where a trust or an institution has been granted registration under Section 12AA or has obtained registration at any time under Section 12A [as it stood before its amendment by the Finance (No. 2) Act, 1996], and, subsequently, it has adopted or undertaken modification of the objects which do not conform to the conditions of registration, it shall be required to make an application for registration in the prescribed form and manner, within a period of thirty days from the date of such adoption or modification in the objects, and that it is registered under Section 12AA. It is also proposed to insert a new clause (c) in sub-section (1) of the said section so as to provide that the person in receipt of the income shall furnish the return of income referred to in sub-section (4A) of Section 139 within the time allowed under that section. These amendments will take effect from 1st April, 2018 and will, accordingly, apply in relation to assessment year 2018-2019 and subsequent years. Clause 10 of the Bill seeks to amend Section 12AA of the Income-tax Act relating to procedure for registration. It is proposed to amend sub-sections (1) and (2) of the said section so as to give reference of newly inserted clause (ab) in Section 12A. The proposed amendment is consequential in nature. This amendment will take effect from 1st April, 2018 and will, accordingly, apply in relation to assessment year 2018- 2019 and subsequent years.

RATIONALE AND CONTROVERSY PERTAINING TO 12AA REGISTRATIONS

4.6.1 The proposed amendments will resolve certain existing controversies as under:

- There has been considerable amount of confusion with regard to the power of the Commissioner of Income Tax (CIT) in case of amendment to the object clause of Trust Deed or Memorandum of Association. There are numerous cases where the CIT rejected the application for 12AA registration if the Trust Deed did not provide for a clause stating “any amendments shall be subject to prior approval of the CIT”. This amendment should provide relief to organisations applying for 12AA registration, as it clarifies that any amendment to the Trust Deed is the prerogative of the organisation and the CIT has no authority to insist on a prior approval. However, all such amendments should be informed within 30 days. If the organisation fails to inform within 30 days, then such failure could be a reason for cancellation of registration. It may further be noted that these provisions will apply only if the organisation has made some amendments in the objects which do not conform to the conditions of registration, in the prescribed form and manner. In other words, if some amendments which do not violate the conditions are made, then no coercive action can be taken even if such changes are not informed within 30 days.
- The second condition states that an organisation shall furnish the return of income referred to in sub-section (4A) of Section 139 within the time allowed

under that section. This is a positive amendment towards greater compliance. Ironically, a 12AA registered organisation was not mandatorily required to file return unless its income exceeded the taxable limit. With the proposed amendments all 12AA registered organisation have to file returns under Section 139(4A) otherwise non filing of return could be treated as a reason for cancellation of registration.

IMPACT AND LIMITATIONS OF THE CHANGES PERTAINING TO 12AA

4.7.1 The proposed amendments are positive in nature; however, these issues could have been handled in a more holistic manner. For instance, it provides that if there is any change which does not conform to the condition of 12AA registration then only it should be informed to the CIT. Ideally, any change in the object clause should be informed to the CIT because a change which violates the conditions of registration would in any case invalidate the registration of the said organisation.

CHANGES PERTAINING TO FILING OF INCOME TAX RETURN

4.8.1 There are considerable changes with regard to the filing of Income Tax return. The amendments are as under :

- Fee of Rs 5,000/- under Section 234F will be levied, if the income tax return is filed after 30th September but before 31st December and Rs 10,000/- if filed after 31st December. However, the penalty of Rs. 5,000/- and Rs. 10,000/- will be reduced to Rs. 1,000/-, if the taxable income is less than Rs. 5 lakh. In other words, in case of NGOs, normally, the penalty for late filing will be Rs. 1,000/- only because the taxable income is generally Nil.
- The option of filing revised income tax return is now allowed only till the end of the assessment year. In other words, if the last date of filing income tax return is 30th September, 2017, then such return can be revised only before 31st March, 2018.

4.8.2 The following amendment has been made to Section 234E of the Income-tax Act, with effect from the 1st day of April, 2018, namely:—

"234F. (1) Without prejudice to the provisions of this Act, where a person required to furnish a return of income under Section 139, fails to do so within the time prescribed in sub-section (1) of said section, he shall pay, by way of fee, a sum of,—

(a) five thousand rupees, if the return is furnished on or before the 31st day of December of the assessment year;

(b) ten thousand rupees in any other case: Provided that if the total income of the person does not exceed five lakh rupees, the fee payable under this section shall not exceed one thousand rupees.

(2) The provisions of this section shall apply in respect of return of income required to be furnished for the assessment year commencing on or after the 1st day of April, 2018.".

5. EXEMPTIONS SHALL BE WITHDRAWN IF IT RETURN NOT FILED IN TIME

INTRODUCTION

5.1.1 The Finance Act 2017 has amended Section 12A and 12AA of the Income Tax Act. It may be noted that Section 12A and 12AA are the sections under which a charitable organisation applies for registration as an exempted organisation. The proposed amendments provide that any organisation availing benefit of tax exemption under Section 11 should be subjected to the following additional conditions:

i. the organisation should inform the Commissioner of Income Tax within 30 days if there is any change in the object clause which changes the character of the organisation

ii. the organisation should file Income Tax Returns under Section 139(4A).

In this issue we will discuss the implications of delayed filing of Income Tax Returns. It seems that the Income Tax exemptions available to charitable organisation will not be available, if the Income Tax Return is not filed within the due date i.e. 30th September of each year.

CONDITIONS FOR EXEMPTION U/S. 11 & 12

5.2.1 Section 12A of the Income Tax Act used to impose two conditions for exemption for under Section 11 & 12. This conditions were very simple, firstly the organisation should be registered under Section 12AA and secondly the organisation should have audited its accounts if they exceed the maximum amount which is not chargeable to income tax.

5.2.2 However, the Finance Act, 2017 put two more additional conditions under Section 12 and provides for mandatory filing of return within the time allowed as 3rd condition under Section 12. These are:

i. Fresh Application for Registration if Trust Deed or MOA is amended: The organisation shall be required to obtain fresh registration by making an application within a period of thirty days from the date of such adoption or modifications of the objects in the prescribed form and manner. At present, there is no explicit provision in the Act which mandates said Trust or institution to approach for fresh registration in the event of adoption or undertaking modifications of the objects after the registration has been granted.

ii. No benefit under Section 11 and 12 if return not filed in time: the entities registered under Section 12AA are required to file return of income, if the total income without giving effect to the provisions of Sections 11 and 12 exceeds the maximum amount which is not chargeable to Income Tax. To provide clarity in this regard, clause (ba) has been inserted in Sction 12A(1) so as to provide for further condition that the person in receipt of the income chargeable to income-tax shall furnish the return of income within the time allowed under Section 139 of the Act.

THE AMENDED PROVISIONS

5.3.1 The relevant provision as proposed to be inserted is as follows:

"In section 12A of the Income-tax Act, in sub-section (1), with effect from the 1st day of April, 2018 –

(i) After clause (aa), the following clause shall be inserted, namely:

"(ab)", the person in receipt of the income has made an application for registration of the trust or institution, in a case where a trust or an institution has been granted registration under section 12AA or has obtained registration at any time under section 12A [as it stood before its amendment by the Finance (No. 2) Act, 1996], and, subsequently, it has adopted or undertaken modifications of the objects which do not conform to the conditions of registration, in the prescribed form and manner, within a period of thirty days from the date of said adoption or modification, to the Principal Commissioner or Commissioner and such trust or institution is registered under section 12AA;";

(ii) After clause (b), the following clause shall be inserted, namely:

"(ba) the person in receipt of the income has furnished the return of income for the previous year in accordance with the provisions of sub-section (4A) of section 139, within the time allowed under that section."

IMPLICATIONS OF AMENDMENTS ON FILING OF RETURN

5.4.1 The impact of the above proposed amendment is that if any entity registered under Section 12A does not file Income Tax return within the due date, then the entity will lose its exemption under Section 11 for that particular year for which the return has not been filed.

5.4.2 Though it is a positive step to compel all organisations to file return on time, however the penalty is very harsh as the entire exemptions will be withdrawn. Such a severe penalty has been provided without remedial measures once the due date for filing return is over, the organisation will automatically lose tax exemptions for that particular year.

5.4.3 The proposed amendments will take effect from 1st April, 2018 and will, accordingly, apply in relation to assessment year 2018- 2019 and subsequent years. In other words, they will not apply for the return filed in the current year.

IMPLICATIONS OF AMENDMENTS IN TRUST DEED

5.5.1 There has been a considerable amount of confusion with regard to the power of the CIT in case of amendment to the object clause of Trust Deed or Memorandum of Association. There are numerous cases where the CIT rejected the application for 12AA registration if the Trust Deed did not provide for a clause stating "any amendments shall be subject to prior approval of the CIT". This amendment should provide relief to organisations applying for 12AA registration, as it clarifies that any amendment to the Trust Deed is prerogative of the organisation and the CIT has no authority to insist on a prior approval. However, all such amendments should be informed within 30 days. If the organisation fails to inform within 30 days, then such failure could be a reason for cancellation of registration. It may further be noted that these provisions will apply only if the organisation has made some amendments in the objects which do not conform to the conditions of registration, in the prescribed form and manner. In other words, if some amendments which do not violate the conditions are made then no coercive action can be taken even if such changes are not informed within 30 days.

Further, the information to the CIT is to be given in a fresh application for registration which will create confusion regarding the status of existing registration.

6. INCOME TAX RETURNS IN THE AMENDED ITR-7

OVERVIEW OF FILING OF RETURN

6.1.1 In this issue the procedure pertaining to filing of return under the Income Tax Act has been discussed. After the Finance Act, 2017 there has been significant changes in the ITR-7 Form (the form in which all the NPOs and Trusts have to file their return), the implications of such changes have also been discussed.

6.1.2 All charitable organisations having income exceeding the maximum amount which is not chargeable to income tax during the previous year are required to file their returns of income. Currently, the maximum amount which is not chargeable to income tax is Rs. 2.5 lakhs per year.

6.1.3 The 'income' for the purposes of filing the return should be computed without giving effect to the provisions of Sections 11 and 12 of the Act. This means Trust & Societies are required to submit their return if the income is more than the basic exemption limit and in case of Section 8 company, the return has to be filed even if there is Re.1/income, as for Section 8 company there is no basic exemption limit. The return is to be filed as per the provisions of Section 139(4A) and (4C) in the manner provided in Section 139 of the Act.

6.1.4 The Taxation Laws (Amendment) Act, 2006 has amended Section 139(4C)(e) and also inserted a new sub-section (4D) in Section 139. As a consequence, medical institutions under Section 10(23C)(iiiae) having gross receipts of Rs. 1 crore or less are also required to file return if the income exceeds the maximum amount which is not chargeable to income-tax during the previous year.

6.1.5 Further, the organisations notified under Section 35(1)(ii) & (iii) are also required to file annual return if the income exceeds the maximum amount which is not chargeable to Income Tax during the previous year.

6.1.6 Upto the Assessment Year 2015-16, the organisations claiming exemption under sub-section (iiiab) & (iiiac) of Clause 23C of Section 10 i.e. university or other educational institution, Medical institution existing solely for educational/medical purposes and not for purposes of profit & which is wholly or substantially financed by the Government were exempted from furnishing of return. However, Finance Act, 2015 has proposed that these organisations shall also have to file their Income Tax Return u/s. 139 w.e.f. 2016-17.

6.1.7 The last date of filing of return is 30th September of the Assessment Year.

MAJOR CHANGES IN THE NEW ITR-7 FORM BY FINANCE ACT 2017 FOR ASSESSMENT YEAR 2017-18

6.2.1 Now onwards, in addition to detail of Audit Report in Form 10B, the details of the Audit conducted under any other Act other than Income Tax Act is also required to be furnished. For example, if audit is done under Service Tax / VAT, the details of audit i.e. act, section, date of audit report, etc. needs to be furnished.

6.2.2 There is a major shift in the disclosure of income in the form, the primary income of NGOs is no longer required to be computed under five heads of income, such as *Income from House Property, Income from Business and Profession* etc. The statement of income as per Part-B TI has undergone a major change and now Point

No. 1 to 7 of Part-B TI has been specifically designed for NGOs registered u/s. 12A/ 12AA and the income to be computed under various heads of income has been done away with.

6.2.3 Now any income other than voluntary contribution towards corpus/ voluntary contribution has to be segregated as required in **Schedule AI** which requires disclosure of total income under following heads:

1. Receipts from main objects
2. Receipts from incidental objects
3. Rent
4. Commission
5. Dividend income
6. Interest income
7. Agriculture income
8. Any other income (specify nature & amount)

Issues requiring clarity: There is no separate column for Restricted Grant and Capital Gain. Therefore, Capital Gain will be disclosed under "Any Other Income" and Restricted Grant may or may not be shown as Income depending upon the past policy of the organisation towards the treatment of restricted grant. Moreover, Agricultural income though exempted has been included in the bifurcation list of income subject of 85% of application but we understand this should not have been included in this list as agricultural income is exempted.

6.2.4 Similarly, Revenue expenses are now required to be segregated in Schedule ER which requires the following disclosures:

1. Rents
2. Repairs
3. Compensation to employees
4. Insurance
5. Workmen and staff welfare expenses
6. Entertainment and Hospitality
7. Advertisement
8. Commission
9. Royalty
10. Professional / Consultancy fees / Fee for technical services
11. Conveyance and Travelling expenses other than on foreign travel
12. Foreign travel expenses
13. Scholarship
14. Gift
15. Donation
    i. Corpus
    ii. Other than corpus
16. Rates and taxes, paid or payable to Government or any local body (excluding taxes on income)
17. Audit fee
18. Other expenses (specify nature and amount)

19. Total
20. Bad debts
21. Provisions
22. Interest
23. Depreciation and amortization
24. Total revenue expenses

Issues requiring clarity:

- There is no separate column for Program Expenses and therefore, it can be mentioned under Point 18.
- Again, by including depreciation and amortization may create confusion as in most cases they are not considered as an application of income.
- Moreover, various heads of classifications of expenses is not related to those heads of expenses normally maintained by an NGO.
- Sl. No. 19 which asks for Total is not clear.

6.2.5 Similarly, amounts applied for charitable purpose towards capital expenditure need segregation as per Schedule EC. It also requires disclosure of the net consideration received from transfer of assets minus exemption under Section. 11(1A).

6.2.6 Schedule VC requires bifurcation of Voluntary Contributions (other than corpus fund) into –

a. Grants received from Government
b. Grants received from Companies under Coporate Social Responsibility
c. Other donations

6.2.7 A separate Schedule 115TD has been included to furnish accreted income under Section 115TD.

6.2.8 Now, while submitting the details of bank account, details should also be furnished for the cash deposited during 09/11/2016 and 30/12/2016, if the aggregate cash deposit is equal or more than Rs.2 Lac.

6.2.9 Now, Aadhaar number is required to be provided in Schedule "K" for the founders/ authors and trustees. {if available}

MAJOR CHANGES IN ITR - 7 FORM BY FINANCE ACT 2016 FOR ASSESSMENT YEAR 2016-17

6.3.1 CBDT has notified the new ITR Form for Assessment Year 2016-17, the major changes in ITR-7 are as follows:

6.3.2 **Business Receipts:**

The Finance Act, 2015 had substituted the proviso to Section 2(15) to provide that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, unless:

i. such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and
ii. the aggregate receipts from such activity or activities during the previous year, do not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year.

In other words, advancement of any other object of charitable purpose shall not be deemed as charitable, if receipts from any commercial activity exceed 20% of total receipts.

Accordingly, a new row is inserted in ITR 7 to disclose the percentage of business receipts vis-a-vis total receipts in order to ensure that such condition (as given hereinabove) is not violated.

6.3.3 **Application of income by a Trust:**

Income of charitable or religious trust is exempted, if 85% of its income is applied for charitable or religious purposes in India. If income applied for charitable or religious purposes during the previous year falls short of 85% because such income has not been received during the year or due to any other reason, an option is given to the assessee to apply such income in future years in the prescribed manner. Assessee has to choose such an option by filing up Form 9A to the Assessing Officer before the due date of filing return of income under Section 139(1).

Now a separate row is provided in the new ITR 7 requiring trust to confirm if it has filed Form 9A to exercise such an option and the date of filing of such form.

6.3.4 **Details to be given by Universities, Hospitals, Educational Institutions:**

Exemption under sub-clause (iiiab) and (iiiac) of Section 10(23C) is available to the universities or educational institutions, hospitals or other institutions which are wholly or substantially financed by the Government, subject to certain prescribed conditions. The Finance Act, 2015 has amended the provisions of Section 139 to provide that such entities covered under the clauses (iiiab) and (iiiac) of Section 10(23C) shall be mandatorily required to file their returns of income.

Now such universities, hospitals, educational institutions, etc., have to disclose their name and annual receipts in new ITR 7. Further, they are also required to disclose the amount eligible for exemption in ITR 7.

DELAYED SUBMISSION OF RETURN AND FORM 10

6.4.1 An organisation which fails to furnish its return of income within the due date can still submit its return of income any time before the expiry of the assessment year.

6.4.2 Under Section 272A(2)(e), any voluntary organisation which fails to furnish the return of income which is required to be furnished under sub-sections (4A) and (4C) of Section 139 or fails to furnish it within the time allowed and in the manner required under that sub-section, it shall pay by way of penalty a sum of Rs. 100 per day during which the failure continues. Before imposing such penalty, an opportunity of being heard shall be given to the organisation.

6.4.3 **The Finance Act, 2015 has provided that:**

a. In order to claim the benefit of accumulation of income for five years, Form 10 has to be submitted within the time limit provided for submitting the return u/s. 139(1) and also in such cases Return of Income has to be filed on time by the organisation.

b. The option in terms of explanation 2 to Section 11 has to be exercised in writing and has to be submitted before the expiry of time limit as provided u/s. 139(1), though in such case the submission of return can be delayed.

SUBMISSION OF RETURN

6.5.1 The Return has to be filed in ITR-7 and w.e.f. F.Y. 2013-14, e-filing of Income Tax Return has become mandatory.

6.5.2 Signature can be put through digital signature or submitting the verification of the return in Return Form ITR-7 & then send the same to Income Tax Centralized Processing Centre, Prestige Alpha, No. 48/1 & 48/2, NH-7, Basapura, Bengaluru, Karnataka560100 after signature.

EXEMPTIONS WILL BE LOST FOR DELAYED FILING OF RETURN

6.6.1 The Finance Act 2017 has made very harsh amendment with regard to delayed filing of Income Tax Returns. Now onwards, if the return is not filed on time, the entire exemptions shall be forfeited for that particular year. The Income Tax exemptions that are available to the charitable organisation will not be available, if the Income Tax Return is not filed within the due date i.e. 30th September of each year. The impact of the above proposed amendment that if any entity registered u/s. 12A does not filed Income Tax return within the due date, then the entity will lose its exemption u/s.11 for that particular year for which the return has not been filed.

6.6.2 Though it is a positive step to compel all organisations to file return on time, however the penalty is very harsh as the entire exemption will be withdrawn for that particular year. Normally, for all other income tax assessee, there are some interest penalties for delayed filing of return. In case of Trust, such a severe penalty has been provided without remedial measure.

6.6.3 The proposed amendments will take effect from 1st April, 2018 and will, accordingly, apply in relation to the assessment year 2018- 2019 and subsequent years. In other words, they will not apply for the return to be filed in the current year.

KEY CHANGES IN THE PROCESS OF EXERCISING OPTION UNDER SECTION 11

6.7.1 Section 11 of the Income Tax Act provides two options to the assessee trust when the application of income falls short of 85% of income.

6.7.2 **Option – I: Section 11(1)**

Where the income could not be applied due to non-receipt of the income or any other reason-the income can be spent in the year of receipt/next year.

Presently, no specific format has been provided and the option is exercised in writing to the Assessing Officer before the expiry of the time allowed for furnishing of its return of income u/s 139(1) as specified in Rule 17.

6.7.3 **Option -II: Section 11(2)**

An accumulation for specific project for specific purpose is also allowed for a maximum period of five years. Presently, such option is exercised in writing to the Assessing Officer in Form 10 before the expiry of the time allowed for furnishing of its return of income u/s 139(1) as specified in Rule 17.

6.7.4 Rule 17 has been amended vide Notification dt. 14/01/2016 w.e.f. 01/04/2016 and now as per the amended Rules Form 9A has been notified for exercise of option under Section 11(1) and Form 10 has been modified for option u/s 11(2) for accumulation upto Five years.

6.7.5 The option in Form No.9A referred to in sub-rule (1) and the statement in Form No.10 referred to in sub-rule (2) shall be furnished electronically either under digital signature or electronic verification code. Copy of notification together with Form 9A & modified Form 10 is enclosed herewith.

ONLINE FILING OF AUDIT REPORT IN FORM 10B

6.8.1 With effect from Assessment Year 2013-14, it has also become mandatory to upload online audit report in Form 10B.

REVISION OR CORRECTION OF MISTAKES (IN THE RETURN ALREADY SUBMITTED)

6.9.1 The concerned organisation can file a revised return at any time before the expiry of one year from the end of the assessment year or completion of the assessment, whichever is earlier, only if there is any mistake or omission in the return. For instance, the income tax return submitted for the Assessment Year 2013-14 can be revised any time on or before 31st March, 2015, provided the Assessing Officer has not completed the assessment in the intervening period. However, it is to be noted that return can be revised only if the original return is filed within due date.

FILING OF RETURN BY UNREGISTERED ORGANISATIONS

6.10.1 Charitable / Religious Organisations, which are not registered u/s 11 or u/s 10(23C) of the Income Tax Act and do not enjoy any exemption on their income. Hence, they are liable to file the return if the voluntary contribution received by them or their income exceeds the maximum amount which is not chargeable to income-tax in any previous year. Such organisations should file their Income Tax Return in ITR-7. The tax rate applicable to such organisations will be that of an individual, in other words, income up to Rs. 2.5 lakh shall be exempted. However, for Section 8 Company, there is no basic exemption limit, ITR needs to submitted irrespective of amount of income.

Annexure 1

NOTIFICATION REGARDING ACCUMULATION OF INCOME

[TO BE PUBLSIHED IN THE GAZETTE OF INDIA EXTRAORDINARY, PART II, SECTION 3, SUB-SECTION (ii)]

GOVERNMENT OF INDIA
MINISTRY OF FINANCE
DEPARTMENT OF REVENUE
[CENTRAL BOARD OF DIRECT TAXES]

(INCOME – TAX)

Notification

New Delhi, the 14th January, 2016

S.O. 127 (E).- In exercise of the powers conferred by section 11 read with section 295 of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby makes the following rules further to amend the Income-tax Rules, 1962, namely:-

1. (1) These rules may be called the Income-tax (1st Amendment) Rules, 2016.

(2) They shall come into force from the 1st day of April, 2016.

2. In the Income-tax Rules, 1962 (hereinafter referred to as the said rules), for rule 17, the following rule shall be substituted, namely:-

"**17. Exercise of option etc under section 11.** (1) The option to be exercised in accordance with the provisions of the *Explanation* to sub-section (1) of section 11 in respect of income of any previous year relevant to the assessment year beginning on or after the 1st day of April, 2016 shall be in Form No. 9A and shall be furnished before the expiry of the time allowed under sub-section (1) of section 139 for furnishing the return of income of the relevant assessment year.

(2) The statement to be furnished to the Assessing Officer or the prescribed authority under sub-section (2) of section 11 or under the said provision as applicable under clause (*21*) of section 10 shall be in Form No. 10 and shall be furnished before the expiry of the time allowed under sub-section (1) of section 139, for furnishing the return of income.

(3) The option in Form No. 9A referred to in sub-rule (1) and the statement in Form No.10 referred to in sub-rule (2) shall be furnished electronically either under digital signature or electronic verification code.

(4) The Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, shall-

(i) specify the procedure for filing of Forms referred to in sub-rule (3);

(ii) specify the data structure, standards and manner of generation of electronic verification code, referred to in sub-rule(3), for purpose of verification of the person furnishing the said Forms; and

(ii) be responsible for formulating and implementing appropriate security, archival and retrieval policies in relation to Forms so furnished.".

3. In the said rules, in Appendix II,-

(a) after Form No.9, the following Form shall be inserted, namely:-

"FORM NO.9A

[*See* rule 17(1)]

Application for exercise of option under clause (2) of the *Explanation* to sub-section (1) of section 11 of the Income - tax Act, 1961.

To

The Assessing Officer,

I, ,…… on behalf of *[name of the trust/institution/association]*…… *Permanent Account Number (PAN)*…… do hereby wish to exercise the option referred to in clause (2) of the Explanation to sub-section (1) of section 11 of the Income-tax Act, 1961 for an amount of Rs……(detailed in A below) to be deemed to be the income applied for charitable or religious purposes during the previous year 20..- 20.. for the reasons mentioned in B below.

A. The details of income in this regard are:

(i) Amount of income derived from property held under trust / held under trust in part, during the above mentioned previous year: Rs……;

(ii) Amount of income [out of (i)] actually applied to charitable or religious purposes in India: Rs ……;

(iii) Amount of income referred to in (ii) that falls short of 85% of the income referred to in (i) : Rs……;

(iv) The amount of income in respect of which the option is being exercised: Rs……

B. The reasons for the shortfall in application of income are as under:-

(a)Whether the income was not received during the previous year? Yes/No.

If Yes, the amount of income that was not received:……;

(b) any other reason ? Yes/No

If yes, then specify the reason and the corresponding amount of income:

Sr.No	Reason for shortfall	Amount of Income

Date:

Signature……
Designation……
Address……

Note:

1. This option Form should be signed by a trustee/principal officer.
2. Delete the inappropriate words.";

(b) for Form No.10, the following Form shall be substituted, namely:-

"FORM NO.10

[*See* rule 17(2)]

Statement to be furnished to the Assessing Officer/Prescribed Authority under sub-section (2) of section 11 of the Incomer-tax Act, 1961

To
The Assessing Officer/ Prescribed Authority,
.....
.....

I, ... on behalf of..... *[name of the trust/institution/association]* Permanent Account Number ..... hereby bring to your notice that it has been decided by a resolution passed by the trustees/governing body, by whatever name called, on..... that, out of the income of the trust/institution/association for the previous year, relevant to the assessment year 20....-20...., an amount of Rs..... which is .....per cent of the income of the trust/institution/association for the said previous year, shall be accumulated or set apart for carrying out the purposes of the trust/association/institution. The details of the amount, the purpose and period of the proposed accumulation or setting apart is as under:-

Sr.No.	Purpose for which amount is being accumulated or set apart	Amount	Period of accumulation/setting apart ending on
1			
2			
3			

2. The amount so accumulated or set apart has been invested or deposited in any one or more of the forms or modes specified in sub-section(5) of section 11 of the Income-tax Act, 1961.

3. It is further brought to your notice that the said ..... [name of the trust/institution/association] had in respect of an assessment year preceding the relevant assessment year given the statement regarding accumulation or setting apart of an amount as required under sub-section (2) of section 11 of the Income-tax Act, 1961 as detailed below:

Year of accumulation	*Date of filing Form 10*	*Amount accumulated*	*Period for which accumulated/ set apart*	*Amount applied up to the end of the previous year*	*Amount remaining for application*	*Amount deemed to be income within meaning of sub-section (3) of section 11*

4. It is also brought to your notice that , out of incomes detailed in 3 above, due to the order/ injunction of the court the income as detailed below could not be applied for the purpose for which it was accumulated or set apart:-

S.No.	*Amount of income*	*Previous year in which accumulated or set apart*	*Period during which it could not be applied due to court order*	*Details of court order*

Date: .....

Signature.....

Designation.....

Address.....

Notes:

1. This statement should be signed by a trustee/principal officer.
2. Delete the inappropriate words.".

Notification No.3/2016 /2015 [F. No. 142/16/2015-TPL]

(R LAKSHMI NARAYANAN)
Under Secretary (Tax Policy and Legislation)

Note: - The principal rules were published in the Gazette of India Extraordinary, Part II, Section 3, Sub-section (i), *vide* notification number S.O. 969(E), dated the, 26th March, 1962 and last amended *vide* notification number S.O- 3545 (E), dated the 30th December, 2015.

7. HOW TO PREPARE STATEMENT OF INCOME & ACCUMULATION

INTRODUCTION

7.1.1 The organisations registered under Section 12AA of Income Tax Act, 1961 are required to prepare the Income and Expenditure Account strictly as per Section 11 for the purposes of filing return and assessment of income. It is sometimes confusing to draw a Statement of Computation of Income. Some common mistakes and confusions arise in the following area:

- **Whether 15% accumulation can be charged against the income irrespective of deficit or surplus.** In other words, some organisations get a deficit after charging 15% accumulation which is incorrect, as explained in this issue.
- **Whether corpus donation should be included in income or be excluded.** If the definition of income is referred under Section 2(24)(iia), then corpus donation is also included in income, therefore, should be a part of income under Section 11(1) and subsequently be deducted under Section 11(1)(d) as deemed utilisation. However, under the Section 12(1) corpus donation has been specifically excluded from the scope of income. If the provisions of Section 12(1) are applied, then Section 11(1)(d) does not remain relevant. Therefore, two interpretations are possible:

  i. Corpus Donation should be included as a part of income and then be deducted under Section 11(1)(d) to that extent, in such computation the 15% indefinite accumulation available to the assessee will be higher.

  ii. Corpus Donation is excluded for the purposes of Section 11(1) by virtue of the exclusion from income created under Section 12(1).

- **Expenditure incurred to earn the income.** Such expenditure normally is not treated as application towards charitable purposes; the income should be derived only after deducting such expenditures. In other words, all charge against income should be deducted first in order to derive the income available for charitable purposes. Such expenditure will include fund raising expenditure.
- **Administrative and establishment expenditures.** Such expenditures normally are treated as application towards charitable purposes, unless such expenditure can be separately identified and be treated as distinct from application for charitable purposes. There are cases where it has been held that administrative and establishment expenditures should be treated as application for charitable purposes.
- **Expenditure on incidental business activity or income generation activity.** The income as well as expenditure from such activity should be separately accounted and the net surplus or deficit should be added to the income available for application.

– **Income from restricted grant.** The restricted grant or legal obligations are not treated as income. However, any income from such fund should be treated as a part of income under Section 11(1). The income may be applied for the restricted purposes, if any, with suitable notes.

– **Expenditure towards capital assets.** The entire amount applied on creating capital assets should be treated as an application for charitable purposes. No further depreciation will be available on such assets.

– **Income from sale of assets.** The gross receipt should be treated as income, subject to 85% application. Alternatively, the benefits of Section 11(1A) can also be claimed. In such cases, a distinction has to be made between assets which were charged as 100% application in the year of purchase and assets which are depreciated over the years.

HOW TO COMPUTE 15% INDEFINITE ACCUMULATION

7.2.1 15% of Gross income should be charged against the unspent portion and not the entire income: The Supreme Court of India in *Additional Commissioner of Income Tax v. A.L.N. Rao Charitable Trust* [1995] 129 CTR 205/216 ITR 697/83 Taxman 252 held that Section 11(1)(a) operates on its own. By its operation two types of income earned by the trust during the previous year from its properties are given exemption from income-tax,

i. that part of the income of previous year which is actually spent for charitable or religious purposes in that year; and

ii. out of the unspent accumulated income of the previous year 25% (now 15%) of such total property income or Rs. 10,000, whichever is higher, can be permitted to be accumulated by the trust, earmarked for such charitable or religious purposes. In other words, the available surplus or 15% shall be accumulated, 15% accumulation cannot be charged against income when the final result is deficit.

One can accumulate 15% of the 'Total Income' before deducting applications, the quantum of application cannot exceed the unspent balance.

15% OF INCOME BEFORE APPLICATION SHALL BE ACCUMULATED UNDER SECTION 11(2)

7.3.1 The Supreme Court of India in *CIT v. Programme for Community Organisation* [2001] 116 Taxman 608 affirmed the decision of the Kerala High Court in *CIT v. Programme for Community Organisation* [1997] 228 ITR 620 that Trust was entitled to exemption under Section 11 at 25 percent* of its total income derived, not on amount remained after expending money on charitable purposes out of its total income.

Annexure 1

STATEMENT OF COMPUTATION OF INCOME

Particulars	***Amount (Rs.)***	***Amount (Rs.)***
Source of Total Income		
Income from Donation & Contribution	xxxx	
Gross Surplus*from incidental incomegeneration activities	xxxx	
Income from incidental business activities		
Capital Gains**	xxxx	
Interest/Dividend Income from investments	xxxx	
Corpus Donation***	xxxx	
Any other Income	xxxx	
Total of Income		xxxx
Balance		**xxxx**
Less : Expenditure towards earning suchIncome	xxxx	
Income available for application undersection 11(1)		**xxxx**
Application of Income		
Payment to and Provision for employees	xxxx	
Administrative & Establishment Expenses	xxxx	
Auditor's remuneration	xxxx	
Depreciation	xxxx	
Capital Gain** (not sale consideration) asDeemed Application under Section 11A	xxxx	
Corpus Donation*** (deemed application)under section 11(1)(d)	xxxx	
Any other application towards charitablepurposes (including both revenue and capitalnature)	xxxx	
Total of Applications out of current year'sIncome		xxxx
Surplus Income or (deficit)		**xxxx**
Less: Amount accumulated or set apart for application for charitable purpose being 15%**** under section 11(1)		xxxx
Surplus Income or (deficit)		**xxxx**

*Subject to common cost and use of common infrastructure. Otherwise, net income should be reflected.
**To claim Capital Gain the entire amount of sale proceeds should be invested otherwise the appropriate fraction should be claimed.
***The corpus donation can also be excluded in terms of section 12(1).
****Maximum 15% accumulation or unspent balance to be reduced to nil, excluding corpus donation in the light of Section 12(1).

8. ASSESSMENT AND THE POWER OF ASSESSING OFFICER TO DENY EXEMPTIONS

INTRODUCTION

8.1.1 It has been noticed that under Section 143(3) of the Income Tax Act, 1961 many NGOs lose their tax exemptions in the light of commercial or incidental business activities. However, the Assessing Officer (AO) does not have any powers to ignore the charitable status during assessment under Section 143(3). An organisation continues to remain charitable unless its charitable status is cancelled under Section 10(23C) or 12AA(3). The Finance Act, 2012 has made amendment to Section 143(3) which provides that in case of loss of exemption, a charitable organisation shall be subjected to tax for that particular assessment year only. Further, the Assessing Officer shall confine to the provisions of Sections 11 to 13 for the assessment, exemptions or forfeiture, as the case may be. The memorandum to the Finance Bill, 2012 also clarifies this issue, the relevant extract is as under:

"There is, therefore, need to expressly provide in law **that no exemption would be available for a previous year, to a trust or institution to which first proviso of section 2(15) become applicable for that particular previous year. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution.** Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable due to application of first proviso on account of commercial receipt threshold provided in second proviso in a previous year. Then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year for which such proviso is applicable."

AMENDMENTS BY FINANCE ACT, 2012 TO SECTION 143(3)

8.2.1 The Finance Act, 2012 has made the following changes to the Act with retrospective effect from the 1st day of April, 2009:

In section 143(3), following proviso has been inserted:—

"Provided also that notwithstanding anything contained in the first and the second proviso, no effect shall be given by the Assessing Officer to the provision of clause (23C) of section 10 in the case of a trust or institution for a previous year, if the provisions of the first proviso to clause (15) of section 2 become applicable in the case of such person in such previous year, whether or not approval granted to such trust or institution or notification issued in respect of such trust or institution has been withdrawn or rescinded."

Notes on Clauses to the Finance Bill, 2012

8.2.2 Clause 5 of the Bill seeks to amend Section 10 of the Income-Tax Act relating to income not included in total income. It is proposed to insert a new proviso after the sixteenth proviso to clause (23C) of the aforesaid section so as to provide that the income of a Trust or institution referred to in sub-clause (iv) or sub-clause (v) shall be included in its total income of the previous year, if the provisions of the first proviso to clause (15) of Section 2 becomes applicable to such trust or institution in the said previous year, whether or not any approval granted or notification issued in respect of such trust or institution has been withdrawn or rescinded. This amendment will take effect

retrospectively from 1st April, 2009 and will, accordingly, apply in relation to the Assessment Year 2009-2010 and subsequent assessment years.

8.2.3 Clause 6 of the Bill seeks to amend Section 13 of the Income-Tax Act relating to Section 11 not to apply in certain cases. It is proposed to insert a new sub-section (8) in the aforesaid Section 13 so as to provide that nothing contained in Section 11 or Section 12 shall operate so as to exclude any income from the total income of the previous year of the person in receipt thereof if the provisions of the first proviso to clause (15) of Section 2 become applicable in the case of such person in the said previous year. This amendment will take effect retrospectively from 1st April, 2009 and will, accordingly, apply in relation to the Assessment Year 2009-2010 and subsequent assessment years.

CAN THE ASSESSING OFFICER TREAT AN NGO LIKE A COMMERCIAL ENTITY

8.3.1 On a careful study of the statute and the judicial precedence, it seems that the Assessing Officer does not have power to ignore the registration of a charitable organisation during the assessment proceedings. It has been held in *Madhya Pradesh Madhyam v. CIT* [2002] 256 ITR 277/125 Taxman 382 (MP), that the IT authorities are bound by Registration, once they have registered an institution as charitable one, they cannot go behind registration in assessment proceedings. The NGO can be subjected to tax only if it is conclusively settled that the NGO is engaged in business activities which require opportunity of being heard and determination of legal issues and facts. The power to withdraw registration is only with the Commissioner of Income Tax and the Act does not provide any power to the Assessing Officer of going behind registration during the assessment proceedings. The incidence of business activities, unless it violates the provisions of Section 11(4A), cannot result in tax liability for forfeiture of income under Section 13. Therefore, the Assessing Officer does not seem to possess the power to withdraw charitable status during assessment proceedings. In the above case also the assessee was purportedly engaged in commercial activities and the Court held that the IT authorities had the power to issues show cause notice for cancellation but had no power to go behind registration during the assessment proceedings. **In other words, the tax exemptions should be available unless the registration is permanently revoked under Section 12AA(3).**

SUPREME COURT - ASSESSING OFFICER CANNOT TRAVEL BEYOND SECTION 12AA AND DENY EXEMPTION

8.4.1 It is only to get the benefit of exemption under Section 11 of the Income-tax Act, 1961, a Charitable Trust has register under Section 12AA of the Act in accordance with the procedure laid down in Section 12A. The Commissioner is the statutory authority to grant registration under Section 12AA. The Commissioner after satisfying himself about the objects of the Trust and genuineness of its activities, passes an order within six months registering the Trust. He may also refuse to register the Trust if he is not satisfied, after giving a reasonable opportunity of being heard to the Trust. Once the 12AA registration is granted, there is no power with the Assessing Officer to ignore such registration. In *Asstt. CIT v. Surat City Gymkhana* [2008] 300 ITR 214/ 170 Taxman 612 (SC), the Supreme Court held that once registration is provided than the Assessing Officer cannot probe into the objects as the relevant observation is as under:

"The registration of a trust once done is a fait accompli and the Assessing Officer cannot thereafter make further probe into the objects of the trust."

8.4.2 The Supreme Court affirmed the case of *Hiralal Bhagwati v. Commissioner of Income Tax* [2000] 246 ITR 188 (Guj.) where it was held that once the registration under Section

12A(a) was granted, the grant of benefit and exemptions could not be denied. The ITO was not justified in refusing the benefits which would otherwise accrue under the registration. If there was no registration, as contemplated under Section 12A(a) read with rule 17A, the revenue would have been justified in making a submission that the benefit could not be granted, but where the application for registration was submitted and the registration had been granted, the benefit could not be denied on the ground that the scheme was not for the benefit of the public at large. Therefore, it was to be held that the ITO had erred in denying the benefits under the Act.

8.4.3 The Supreme Court in *U.P. Forest Corpn. v. Dy. CIT* [2008] 297 ITR 1/165 Taxman 533 held that once an order of registration under Section 12AA is passed by the Commissioner, the entire income of the trust becomes exempt under the provisions of Sections 11 and 12 because registration of a Trust is a condition precedent for claiming benefit under section 11(1)(a).

8.4.4 In the case of *Ahmedabad Urban Development Authority v. Dy. Director of Income Tax* (Exemption) [2011] 335 ITR 575/[2010] 233 CTR 407/[2010] 40 DTR 76 (Guj. HC) the Gujarat High Court held that if the 12A registration was not withdrawn on the date of the assessment order then the income of the assessee was exempt in entirety. The Assessing Officer could not have travelled beyond the certificate of registration granted under Section 12AA. The effect of such a certificate of registration under Section 12AA, therefore, cannot be ignored or wished away by the Assessing Officer by adopting a stand that the Trust or institution is not fulfilling conditions for applicability of Sections 11 and 12. Therefore, on this limited count the assessment order appears to be without jurisdiction and the demand in pursuance thereto could not have been sought to be recovered.

8.4.5 In the case of *Deputy Director of Income-tax (Exemption), Ernakulam v. Kuttukaran Foundation* [2012] 19 taxmann.com 331 (Cochin - Trib.) it was held that once registration is granted under Section 12A by Commissioner, Assessing Officer, as a subordinate officer to Commissioner, cannot cancel registration; it is for Commissioner only to cancel registration, provided conditions under section 12AA(3) are satisfied.

The Assessing Officer cannot challenge the pre-existing facts of several years in the absence of any new finding

8.4.6 The other issue which emerges is whether the AO can use the same facts and circumstances for invoking section 13(1) based on which all the past assessment under Section 143(3) were made. The Assessing Officer cannot challenge the charitable status and activities of past years without having any justified reason for taking a different view.

8.4.7 The Delhi High Court in the case of *CIT v. Lagan Kala Upvan* [2003] 179 CTR 243/ 259 ITR 489/126 Taxman 205 the Delhi High Court held that in the absence of any change in the objects and activities of the assessee, the Assessing Officer was not justified in taking a different view only in respect of a particular assessment year. In this case also the Assessing Officer concluded that the assessee was a commercial organisation based on the surplus or profit it had made. However, the assessee had been consistently filing similar returns. The Hon'ble Court held that the Assessing Officer cannot change the precedence of various assessment made in the past in the absence of any new findings.

8.4.8 The Delhi High Court in the case relied on the Supreme Court ruling in the case of *Radhasoami Satsang v. CIT* [1992] 193 ITR 321 where the Hon'ble Supreme Court has laid down very clearly that the Assessing Officer should not interfere with the fundamental aspect permeating through the different assessment years. The

observation of Hon'ble Supreme Court is as under:

"We are aware of the fact that, strictly speaking, res judicata does not apply to income-tax proceedings. Again, each assessment year being a unit, what is decided in one year may not apply in the following year but where a fundamental aspect permeating through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year."

In the light of the above legal ratio laid down by the Supreme Court, it would be legally incorrect on the part of the Assessing Officer to deviate from the basis of the assessments made since inception of the organisation.

8.4.9 The Delhi High Court in the case of *CIT v. Shree Ram Memorial Foundation* [1985] 158 ITR 3, held that when a particular charity was recognised as such for several years and was carrying on the same object without any protest, it is not permissible to question the charitable status from time to time. The High Court cited the observation of the *Privy Council in Trustees of the Tribune Press v. CIT* [1939] 7 ITR 415, that whether an object was charitable was always a question of law. In that sense, it could be said that we would have to determine whether the expenditure in this case was of a charitable nature and hence a question of law arose.

8.4.10 In the case of *Samaj Kalyan Parishad Modinagar v. ITI* [2007] 105 ITD 29 (Delhi) (SB) relying upon the rule of consistency the relief was held allowable to the assessee.

NEW CIRCULAR ON NO CANCELLATION UNDER SECTION 143(3) BY AO

8.5.1 The CBDT has issued Circular No. 21/2016 [F.No. 197/17/2016-ITA-I], dated 27.05.2016, regarding cancellation of registration under Section 12AA. In this circular, it has been clarified that if under proviso to Section 2(15) is attracted in any particular assessment year, then the charitable status of the organisation will not be lost. The circular has further emphasised that any such cancellation under proviso to Section 2(15) read with Section 13(8) will cause undue hardship to the assessee particularly after the enactment of Section 115TD where the networth of the assessee will be subjected to tax in case of cancellation. The relevant extract is as under:

"4. In view the aforesaid position, it is clarified that it shall not be mandatory to cancel the registration already granted u/s 12AA to a charitable institution merely on the ground that the cut-off specified in the proviso to section 2(15) of the Act is exceeded in a particular year without there being any change in the nature of activities of the institution. If any particular year, the specified cut-off is exceeded, the tax exemption would be denied to the institution in that year and cancellation of registration would not be mandatory unless such cancellation becomes necessary on the ground(s) prescribed under the Act.

5. With the introduction of Chapter XII-EB in the Act vide Finance Act, 2016, prescribing special provisions relating to tax on accreted income of certain trusts and institutions, cancellation of registration granted u/s 12AA may lead to a charitable institution getting hit by sub-section (3) of section 115TD and becoming liable to tax on accreted income. The cancellation of registration without justifiable reasons may, therefore, cause additional hardship to an assessee institution due to attraction of tax liability on accreted income. The field authorities are, therefore, advised not to cancel the registration of a charitable institution granted u/s 12AA just because the proviso to section 2(15) comes into play. The process for cancellation of registration is to be initiated strictly in accordance with section 12AA(3) and 12AA(4) after carefully examining the applicability of these provisions."

Annexure 1

THE CBDT CIRCULAR NO. 21/2016

CLARIFICATION REGARDING CANCELLATION OF REGISTRATION UNDER SECTION 12AA OF THE INCOME-TAX ACT, 1961 IN CERTAIN CIRCUMSTANCES

CIRCULAR NO. 21/2016 [F.NO.197/17/2016-ITA-I], DATED 27-5-2016

Sections 11 and 12 of the Income-tax Act, 1961 ('Act') exempt income of charitable trusts or institutions, if such income is applied for charitable purpose and such institution is registered under section 12AA of the Act.

2. Section 2(15) of the Act provides definition of "charitable purpose". It includes "advancement of any other object of general public utility" provided it does not involve carrying on of any activity in the nature of trade, commerce or business etc. for financial consideration. The 2nd proviso to said section, introduced w.e.f. 1-4-2009 vide Finance Act, 2010, provides that in case where the activities of any trust or institution is of the nature of advancement of any other object of general public utility and it involves carrying on of any activity in the nature of trade, commerce or business; but the aggregate value of receipts from such commercial activities does not exceed Rs. 25,00,000 in the previous year, the purpose of such trust/institution shall be deemed as "charitable" despite it deriving consideration from such activities. However, if the aggregate value of these receipts exceeds the specified cut-off, the activity would no longer be considered as charitable and the income of the trust/ institution would not be eligible for tax exemption in that year. Thus an entity, pursuing advancement of object of general public utility, could be treated as a charitable institution in one year and not a charitable institution in the other year depending on the aggregate value of receipts from commercial activities. The position remains similar when the first and second provisos of section 2(15) get substituted by the new proviso introduced w.e.f. 1-4-2016vide Finance Act, 2015, changing the cut-off benchmark as 20% of the total receipts instead of the fixed limit of Rs. 25,00,000 as it existed earlier.

3. The temporary excess of receipts beyond the specified cut-off in one year may not necessarily be the outcome of alteration in the very nature of the activities of the trust or institution requiring cancellation of registration already granted to the trust or institution. Hence, section 13 of the Act has been amended vide Finance Act, 2012 by inserting a new sub-section (8) therein to provide that such organization would not get benefit of tax exemption in the particular year in which its receipts from commercial activities exceed the threshold whether or not the registration granted is cancelled. This amendment has taken effect retrospectively from 1st April, 2009 and accordingly applies in relation to the assessment year 2009-10 onwards.

4. In view of the aforesaid position, it is clarified that it shall not be mandatory to cancel the registration already granted u/s 12AA to a charitable institution merely on the ground that the cut-off specified in the proviso to section 2(15) of the Act is exceeded in a particular year without there being any change in the nature of activities of the institution. If in any particular year, the specified cut-off is exceeded, the tax exemption would be denied to the institution in that year and cancellation of registration would not be mandatory unless such cancellation becomes necessary on the ground(s) prescribed under the Act.

5. With the introduction of Chapter XII-EB in the Act vide Finance Act, 2016, prescribing special provisions relating to tax on accreted income of certain trusts and institutions,

cancellation of registration granted u/s 12AA may lead to a charitable institution getting hit by sub-section (3) of section 115TD and becoming liable to tax on accreted income. The cancellation of registration without justifiable reasons may, therefore, cause additional hardship to an assessee institution due to attraction of tax-liability on accreted income. The field authorities are, therefore, advised not to cancel the registration of a charitable institution granted u/s 12AA just because the proviso to section 2(15) comes into play. The process for cancellation of registration is to be initiated strictly in accordance with section 12AA(3) and 12AA(4) after carefully examining the applicability of these provisions.

6. The above may be brought to the notice of all concerned.

II. FINANCE

1. **ACCOUNTABILITY ASPECTS OF FUND ACCOUNTING**
2. **NGO INHERENT CHARACTERISTICS NECESSITATING FUND ACCOUNTING**

1. ACCOUNTABILITY ASPECTS OF FUND ACCOUNTING

1.1.1 NGOs generally work in fiduciary capacity while implementing developmental projects. The term, *'fiduciary'* has been defined as

"a trustee or a person holding the character of a trustee or a character analogous to trustee".

And the term *'fiduciary capacity'* has been defined as

"One is said to act in a 'fiduciary capacity' or receive money or contract a debt in a "fiduciary capacity", when the business which he transacts, or the money or property which he handles, is not his own or for his own benefit, but for the benefit of another person as to whom he stands in a relation implying and necessitating great confidence and trust on the one part and a high degree of good faith on the other part. The term is not restricted to technical or express trusts, but includes also such offices or relations as those of all attorney at law, a guardian, executor, or broker, a director of a corporation, and a public officer".

1.1.2 The legal connotation of the term 'fiduciary' refers to somebody who is entrusted to hold or manage properties or fund for another. In strict legal parlance, NGOs work in fiduciary capacities for donor agencies. Therefore, they have a donor-wise accountability to manage records and report on the basis of individual projects and funds. Because the normal reporting is done as per the law of the country, which does not require project-wise or fund-wise reporting. The statutory audited statements reflect the true and fair view of the NGO as a whole. It does not necessarily reflect the state of each and every individual fund and project. But since NGOs works in fiduciary capacity they are accountable individually to the specific donors apart from the formal accountability towards the state and other stakeholders.

1.1.3 Fiduciary activities always come with operational accountabilities. When a person manages or utilizes fund on behalf of somebody else he/she has to ensure the following:

– the funds were utilized strictly in compliance with the project agreements and contracts

– the cost of services provided or the administrative component is reasonable and does not involve any element of profit

– in case of investment and properties their title, safety and return are prudent and are as per the project agreement

– project-wise and fund-wise reporting is made as per the project agreement

1.1.4 A true trustee should provide account of every penny of fund spent or retained and such account should be to the satisfaction of the donor agency.

1.1.5 NGOs deal in various kinds of project activities and various kinds of fund are also held at any given point of time. Each project and a fund may have a distinct legal identity and compliance thereof. It is necessary to understand the legal implications of all projects and other funds. Some instances of legal accountability/compliance are as under:

- **Corpus Fund:** A corpus fund enjoys legal privileges for instance it is totally exempt from tax under Indian Tax Laws. All other voluntary contributions are subject to tax unless 85% is utilized. A corpus fund is not required to be spent

under the law but corpus fund being a distinct fund legally created needs to be accounted for as a distinct entity on principles of fund accounting.

- **Restricted Funds:** The project grants received for restricted purposes are bound by the contractual obligations of the project agreement. Therefore, in order to comply with the project agreement fund accounting becomes necessary.
- **Project Assets:** Project assets belong to the donors, subject to the terms of the project agreement. Separate accounting for the assets of each project is necessary in order to meet the legal obligation of the project agreement at the end of the project period.

1.1.6 The doctrine of *Cy pres* means that the general intent of the donor should prevail, therefore if a definite function or duty cannot be done in exact conformity with a desire of the donor then it should be performed with as close an approximation to that scheme as is reasonably practicable.

1.1.7 The Supreme Court of India defined the doctrine of *Cy pres in Ratilal Panachand Gandhi v. State of Bombay*, AIR [1954] SC 388, 394 as under :

'Cy pres' means in some way as nearly as possible when the particular purpose for which a charitable trust is created fails, or it cannot be carried out in whole or in part, the court would not allow the trust to fail but would execute it 'Cy pres' that is to say, in some way as nearly as possible to that which the author of the trust intended."

1.1.8 The doctrine of *Cy pres* is an important legal principle for the NGOs, which means that if a charitable activity cannot be done in particular way specified by the donor then it may be done in a way as close as possible. This doctrine was evolved largely in context of the performance of charitable trusts. A trust once created is bound by the trust deed and even the settlor of the trust cannot make any changes. But, suppose some clauses of the trust deed are not possible to be performed then the court may permit to change the objectives through some other similar objectives.

1.1.9 The doctrine of *Cy pres* provides a strong legal principle about the legal accountability of public fund. NGOs have to work strictly in conformity with the deed or agreement based on which the funds are received. Legally it is not possible to deviate from the project agreement.

1.1.10 The Indian Trust Act, 1882 is not applicable to public charitable trusts but for procedural purposes, even today, the Indian Trust Act, 1882 is one of the most relevant statute. A trust, in fact, is born on the undercurrents of fund accounting. The three certainties of a trust are as under :

i. Certainity of intention to create Trust

ii. Certainity of the objects and the beneficiaries

iii. Certainity of the subject matter of the Trust i.e. fund or properties must be specified and settled in the deed.

1.1.11 It can be seen that having a property or fund is one of the certainties of a trust without which it cannot come into existence legally. And such trust would be null and void. So a public trust is created on the basis of a fund (trust property), which is entrusted to the trustees to be managed as per the trust deed. The trust deed is like an *'endowment fund'* where the income generated from such fund is used for the purposes of the trust. The trust as a legal entity comes into existence for maintenance of a fund or a property and it exists as long as the subject matter of the trust i.e. the fund or the property remains intact.

1.1.12 In today's world an NGO is an enlarged version of the trust as envisaged in the Indian Trust Act, 1882. An NGO simultaneously handles a large number of trusts each one having its specific subject matter or fund. Therefore, the onus is on the NGO to ensure that each fund is maintained individually and independently of other funds.

1.1.13 The legal creation of an NGO, is in the spirit of a custodian of public money which is precisely what fund accounting tries to capture and present. All the public money at the disposal of the NGO are individually recorded and handled as per the desire of the donor or the conditions fixed by the board or the management.

2. NGO INHERANT CHARACTERISTICS NECESSITATING FUND ACCOUNTING

2.1.1 A significant advantage of fund accounting is that an organization can devise the accounting system according to the functions or activities of the organization. As discussed in earlier chapters, NGO work in various capacities simultaneously as they work on behalf of various donors. As a result, the functional responsibilities undertaken for each fund becomes more important for which independent analysis of each fund/project is necessary. Further, it is not necessarily a donor driven system. An organization may use fund accounting for identifying and tracking its own functional activities. For instance, an organization can prepare a separate income and expenditure account only for, say, the overall administrative expenses of the NGO and analyse the appropriation of such expenditure into various restricted and unrestricted projects.

2.1.2 Fund accounting could be applied for a particular activity whether funded from internal or external sources. Fund accounting can be applied at various levels. For instance, within a large fund or a project there may be sub-projects which can be segregated on the basis of the functional differences. Fund accounting can be holistically applied over the entire project by consolidating the statements of all the sub-projects.

2.1.3 Therefore, it can be seen that fund accounting need not necessarily arise on the basis of a particular source of fund. It may be applied on the basis of activities or functions. An NGO instead of maintaining fund accounts for particular donor may maintain separate account for a particular activity. For example, fund accounts may be maintained for *"Tsunami Relief"*, in such a case fund accounting will be done for all the expenditures made for a particular cause rather than for all the funds received from a particular donor. In such fund account, grant received from all the donors for *"Tsunami Relief"* shall be accounted.

2.1.4 To sum up, fund accounting is not an accounting system influenced by donor or anybody else. It is an unconditioned tool available, which the NGOs can use. It may be for preparing individual donor-wise statements, it may also be used for preparing individual activity-wise or function-wise financial records and statements.

2.1.5 Each project and each fund is treated as a fiscally independent body where the budgets and legal obligations can be separately and independently assessed. A fund or a project is treated as a legally separate body where all the financial and legal computation and assessment for that particular fund or project are made independently and separately. For instance, under Section 35AC of the Income Tax Act of India, a project can separately avail exemption for Income Tax purposes. In other words, the organization may not enjoy certain privileges, which are available to one of its project. There are many NGOs in India one of whose project has 35AC exemption. In such a case if donations are made to that particular project then the donor will get 100% exemption. But if the donor makes a voluntary contribution to the same NGO then it may not get any tax exemption. Therefore, fund accounting becomes important in order to maintain the fiscal independence of various funds and projects. The NGOs in order to comply with the legal requirements may have to show a project as an independent fiscal entity. Otherwise also an organisation should be in a position to retain and reflect fiscal independence of all of its projects and funds.

2.1.6 The fiscal independence and identity of funds and projects is analogous to the concept of *"cost centre"* and *"profit centre"* normally used in commercial accounting. In a commercial organisation a company might be doing profit but whether each and every division of its activities is performing equally well is also judged. Therefore, the profit and losses of each division is computed separately and if there are any loss making divisions then remedial measures are taken. A company will not be in a position to identify its loss making divisions if it is not able to compute the division-wise profits and losses. In such a process, each division is treated as a fiscal entity. It may not have any legal or statutory identity but for the sake of financial analysis it is treated as a separate entity.

2.1.7 Similarly, NGOs need to identify various fiscal entities within the sphere of its activities and resources, which can be treated distinctly through application of fund accounting.

2.1.8 Fiscal independence in other words means that a particular fund is independent in terms of its sources as well as expenditures.

2.1.9 In order to maintain the fiscal and legal independence of the project it is necessary to treat them as separate entities, at least, for procedural purposes. Each fund or a project is treated as an independent entity. Therefore, all those financial statements, which are prepared for an organization are also prepared for the specific fund/project. It is more like the holding company and subsidiary company concepts of accounting. A project or a fund is like a wholly owned subsidiary of the NGO. It is 100% owned by the NGO, but at the same time it is a separate entity.

2.1.10 An NGO is a trustee on behalf of the donor for the beneficiary. Therefore, simultaneously an NGO may have a large number of donors and numerous categories of beneficiaries. The stewardship/trusteeship function of NGOs require specific duties to be performed for specific donors as well as beneficiaries. NGOs have to cater a multiple and heterogeneous group of donors and beneficiaries and each having its specific requirement. Therefore, a single set of consolidated statements cannot do justice to its stewardship/trusteeship function. The NGO has to satisfy its donors as well as each class of beneficiaries individually. A consolidated income and expenditure account makes very little sense to a donor who cannot find the break-up of the funds provided by it or the beneficiary who cannot link the activities with the expenditures on the project of his area. Therefore, an NGO being a trustee as an organisation also as project holder for various donors/stakeholders has a multidimensional responsibility which requires individual and specialised financial systems and records.

III. CSR

1. ADMINISTRATIVE AND ESTABLISHMENT EXPENSES
2. CSR EXPENDITURE OUTSIDE INDIA
3. PERMISSIBLE CSR ACTIVITES & SCHEDULE VII
4. UNDERSTANDING CSR ACTIVITIES & CHARITABLE PURPOSE

1. ADMINISTRATIVE AND ESTABLISHMENT EXPENSES

INTRODUCTION

1.1.1 The existing CSR Law does not specify any limit on the administrative expenses. At the same time the CSR law does not seem to be encouraging administrative expenditures. For instance, Rule 4(5) & (6) provide that CSR programme cannot be only for the benefit of the employees, further, the expenditure on employees shall be permissible, upto 5% on capacity building pertaining to CSR.

1.1.2 The CSR Rules, further provide that activities undertaken in pursuance of the normal course of business of the company is not CSR.

1.1.3 Normally administrative expenditure incurred in relation to the programmatic activities is treated as a part of programme expenditures. However, the administrative expenditure should be restricted to certain limit otherwise the money available for programme will get reduced.

1.1.4 The Companies Act, 2013 is silent on the quantum of administrative expenses permissible under CSR, however, it does clarify that expenditure on its own employee will not be treated as CSR expenditure.

1.1.5 Under FCRA law the administrative expenditure is restricted to 50% of total expenditure. The 50% limit looks to be very high but the definition of administrative expenditure under FCRA is complicated and includes various programmatic expenditure also.

1.1.6 There is no specific definition of administrative expenditure under the Income Tax laws, however, various court cases and Central Board of Direct Taxes (CBDT) circulars clarify how and when the administrative expenditure should be charged.

1.1.7 There are cases where it has been held that the establishment or administrative expenditure (other than the Admn. expenditure incurred on programme implementation) should be deducted from the income available for charitable purposes. In other words, in case of CSR expenditure the issue is whether the administrative expenditure should be included for the purposes of 2% spend of Net Profit, or should the 2% CSR expenditure be determined after deducting the administrative expenditure.

1.1.8 In our opinion administrative expenditure should be included as a part of 2% CSR expenditures. However, in case of companies where the CSR activities are directly implemented by the company, it should be ensured that the administrative expenses pertains to the CSR projects of the company. It should not pertain to the corpus or maintenance of corpus assets or towards the core establishment expenses.

1.1.9 There is no accounting standard or mechanism to determine administrative expenses. The judicial precedence is confusing as most of the administrative expenses have been treated as programme expenses. This will result in use of discretionary norms in determining the administrative expenses, affecting the uniformity in reporting under CSR Rules.

ADMINISTRATIVE AND ESTABLISHMENT EXPENSES

1.2.1 Administrative and establishment expenses have always remained an issue for judicial and legislative debate. The prime issue in this regard is whether the income available for charitable purposes should be computed after deducting administrative and establishment expenses or should they be considered as an application for charitable purposes. Or to what extent establishment expenditure would be permitted because there might be a circumstance where the activities are dormant but establishment expenditure still continues.

1.2.2 There are clarifications and cases in context of Income Tax Act which provide insight into the treatment of administrative expenses. There are cases where it has been held that administrative expenses pertaining to the establishment of the organisation should not be treated as charitable expenditure, such expenditure should be first deducted to derive the income available for charitable purposes. Similarly, there are cases where it has been held that administrative expenses pertaining to charitable activity should be treated as charitable expenditure.

1.2.3 The Central Board of Direct Taxes (CBDT) has also issued a circular in this regard. The view of the Department seems to be towards deducting administrative and establishment expenses from the total income to determine the income available for application. Establishment or administrative expenses are considered as a charge to the income of the organisation and, therefore, only the net income after deducting such expenses is available for charitable purposes. *Circular No. 5-P (LXX-6) of 1968, dated June 19, 1968*, states that the income should be computed on the basis of normally accepted commercial principles. Therefore, it implies that establishment expenses should be deducted in order to determine the net income available for application.

1.2.4 Whether such expenses amount to application of income: There seems to be a generic treatment to the establishment expenses and they are considered as application along with other items of expenses, though in strict commercial/ accounting sense, such treatment is debatable. The establishment expenses are a charge on the income and 'application' is analogous to 'appropriation' of the income available for charitable purposes. Administrative and establishment expenses could be of various categories. Some part of which could be directly attributed to the generation of income and some part could be towards charitable or religious purposes. This issue has been debated in various cases, whether establishment expenses can be considered as application for the objects of the organisation.

1.2.5 In *CIT v. Birla Janahit Trust* [1994] 208 ITR 372 (Cal.), the Court opined that *expenses incurred for running a trust should be considered to have been applied for the objects of the trust.* In this case, reference to various other cases was also made. The following extract is very relevant in this regard:

"It appears from the order of the Appellate Assistant Commissioner that the assessee has incurred the expenditure on salaries and miscellaneous expenses for the purpose of carrying out the objects and purposes of the trust and not only to earn the income from dividend. It is now well-settled that in determining the portion of income applied or accumulated for charitable or religious purposes, regard should be had to the trust income in a commercial sense or according to the accounts of the trust and not the total income as computed under the provisions of the Income-tax Act. Our attention has been drawn to several decisions in this connection. In Deo Radha Madhava Lalji Genda Trust v. Property Tax Officer [1980] 125 ITR 531 (MP), it has been observed

that tax liability and other outgoings in respect of the trust property are all incidental expenses relating to and connected with the main objects of the trust, which are exclusively religious and charitable. If the trust property is not properly maintained and proper accounts are not kept, the very existence of the trust would be in jeopardy and its object and purpose would be lost. In this view of the matter, simply because a part of the rental income is spent in the maintenance, repairs, payment of salaries to employees, taxes and legal expenses, etc., it could not be said that the income derived from the trust property was not applied exclusively to religious or charitable purposes."

1.2.6 In *Gem & Jewellery Export Promotion Council v. ITO* [1999] 68 ITD 95 (Mum.), the Tribunal held that the entire non-code expenditure could not be said to have been incurred towards earning of the income and, therefore, only that portion of the expenditure - which could be attributed to the earning of income should be deducted from the gross income for computing the income on which application and accumulation under Section 11(1)(a) of the Income Tax Act was allowed. The following extracts are relevant in this regard:

"It is clear from the decisions cited above, that it is the income computed on commercial principles which is available for purposes of accumulation under Section 11(1)(a). The contention that in the case of Trust, gross receipts is the income of the Trust, in the light of the above decisions, we find is not well founded. We accordingly hold that the income available for accumulation under Section 11(1)(a) is the income as computed on commercial principles, as also taking into account the provisions of the Income-tax Act, 1961.

We, however, agree with the contention on behalf of the assessee, that the entire non-code expenditure cannot be attributed to the earning of the income of the assessee. The contention of the assessee that only a small portion of the expenditure is attributable to the earning of income shall have to be determined by the revenue authorities, after giving an opportunity of being heard to the assessee. For that purpose, the issue is set aside and remitted to the Assessing Officer for working out the expenditure to be deducted out of the gross income, for the purpose of determining the income and then working out the 25% of the same for accumulation."

1.2.7 In other words, the expenditure which can be precisely or reasonably be attributed to earning of income should be deducted first to determine the income available for charitable purposes, the rest portion of expenditure shall be treated as applied towards charitable purposes. **In context of CSR, all those expenditures which are in the nature of a charge to the company's income should be deducted from the Net Profit and should not be shown as applied under CSR. Further, the companies should ensure that the administrative expenses pertain only to the implementation of CSR activities and not towards maintenance of CSR corpus or other establishment expenses.**

CASES WHERE IT WAS HELD THAT ESTABLISHMENT EXPENDITURES SHOULD BE DEDUCTED

1.3.1 There are many cases in context of Income Tax Act which provide insight in to the treatment of administrative expenses. There are cases where it has been held that administrative expenses pertaining to the establishment of the organisation should not be treated as charitable expenditure, such expenditure should be first deducted to derive the income available for charitable purposes.

1.3.1 In *CIT v. Rao Bahadur Calavala Cunnan Chetty Charities* [1982] 135 ITR 485, it was held that the expression *'income'* has to be arrived at after taking into account the receipts and deduction of establishment expenditures. The net amount which will be available for application for charitable purposes should be considered as income for the purpose of Section 11.

1.3.3 The Madras High Court significantly, cited the example of a company which normally distributes dividend out of the business profits and not the assessable income. A company may have substantial assessable income and very little business profits/ available income and vice versa. The same reasoning is required to be applied in case of charitable organisations and the expression 'income', has to be understood in the popular or general sense and not in the sense in which the income is arrived at for the purpose of assessment to tax by applying artificial provisions for either giving or denying deductions.

2. CSR EXPENDITURE OUTSIDE INDIA

CSR EXPENDITURE SHOULD HAPPEN ONLY IN INDIA

2.1.1 Under Rule 4(4) the CSR activities should happen only in India. This issue is also complex and it is necessary to understand what kind of expenditure will qualify and be treated to have been spent in India. Earlier the understanding was that any expenditure incurred, anywhere in the World, in connection to Indian activities, shall be treated as applied in India. However, Delhi High Court in the year 2012 (in context of Income Tax Laws) held that the expenditure should be actually spent in India. In other words, the payment should also have been made in India. For example, a company cannot medically treat a person outside India. Or it cannot import medicine from outside India but can buy imported medicine from a dealer in India.

2.1.2 However, an NPO can have activities outside India subject to tax implications. An NPO can avail specific permission from Central Board of Direct Taxes (CBDT) to have activity outside.

2.1.3 All the provision and procedures pertaining to activity outside India are provided hereunder.

OVERVIEW OF THE LEGAL ISSUES AND PROVISIONS

2.2.1 Under the provisions of Income-tax Act, 1961, income applied on activities outside India is not eligible for exemption unless the following conditions are satisfied:

a. The charitable organisation happens to be a trust created before 1-4-1952 or it is engaged in promotion of international welfare in which India is interested;

b. Central Board of Direct Taxes (CBDT) has by general or special order granted the exemption for carrying out such activities.

2.2.2 An organisation can apply to the CBDT for permission to work outside India. The applications seeking approval u/s 11(1)(c) may be submitted in the office of Member(IT), Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, North Block, New Delhi.

2.2.3 With regard to the Earthquake in Nepal in May, 2015, the Central Board of Direct Taxes has provided the procedure for all applications made u/s 11(1)(c) of the Income Tax Act, 1961 seeking approval for rendering help to the victims of earthquake in Nepal. The documents which are required to be attached are provided in **Annexure-1.**

2.2.4 All organisations should verify whether an enabling clause to work outside India is present in the Constitution/Trust Deed/Memorandum of Association. An organisation should see that the area of operation is not specifically restricted to a particular district, State or India as a country. In such cases, it will not be permissible for them to work outside India without amending the Constitution. In case the Constitution is silent about the area of operation, such organisation may work outside India by passing a special resolution if there is no restrictive clause with regard to area of operation.

2.2.5 It may be noted that if an organisation incurs expenditure outside India in contravention of Section 11(1)(c), then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption and will be taxed.

2.2.6 Further, existence of a clause in the registration document which provides for activities outside India, would not disentitle the organisation from claiming income tax exemptions. The provisions of Section 11(1)(c) are attracted only if actual expenditure is incurred outside India.

2.2.7 Foreign Contribution Act, 2010 (FCRA) is silent regarding expenditure to be incurred in foreign country or activity outside India. However, the Charter for NGOs provided by FCRA department specifically states that activities outside India cannot be conducted with FC Funds, the Charter for NGOs is provided in**Annexure-2.** Further, it specifically provides that if the funds are transferred to another NGO, it can be given only to another FC registered NGO. Therefore, it is advisable to seek permission from FCRA Department to work outside India. FCRA Department may provide specific or general permission u/s. 50 of the Foreign Contribution Regulation Act, 2010 (FCRA). Once the permission is received then only FC fund should be used for carrying out activities outside India.

2.2.8 In order to have a formal transfer of funds and relief material from one country to another, it is advisable to obtain the necessary permission from the Consulate of that Country in India and also inquire about the local laws applicable for such activity.

ACTIVITIES OUTSIDE INDIA NOT EXEMPTED

2.3.1 Under Section 11(1)(c) of the Income-tax Act, any income applied on activities outside India is not eligible for exemption.

2.3.2 A charitable organisation cannot have activity outside India unless it happens to be a trust created before 1-4-1952 or it is engaged in promotion of international welfare in which India is interested. In other words, NGOs registered after 1-4-1952 are not allowed to have any international activity unless such activity is specifically exempted by CBDT. Provisions of Section 11(1)(c) are as under:

"(c) income derived from the property held under trust—

i. created on or after the 1st day of April, 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and

ii. for charitable or religious purposes, created before the 1st day of April, 1952, to the extent to which such income is applied to such purposes outside India:

Provided that Board, by general or special order, has directed in either case that it shall not be included in the total income of the person in receipt of such income;"

From the above provisions, it is clear that organisations created after 1-41952 are not empowered to do activities outside India. However, CBDT in certain circumstances may direct by a general or special order permitting certain activities, which tend to promote international welfare in which India is interested.

SECTION 10(23C) IS SILENT ABOUT THE PLACE OF ACTIVITY

2.4.1 In India, NGOs can be registered under Income Tax Act, both under Section 10(23C)(vi) and also under Section 12AA. NGOs of national importance are granted registration under Section 10(23C). It may be noted that unlike Section 11(1)(c) the third proviso to Section 10(23C)(vi) does not mention the words "in India" with regard to application of funds for charitable and religious purposes. Therefore, it raises the question whether NGOs registered under Section 10(23C) can have some activities outside India. The Supreme Court gave a landmark judgment in *American Hotel & Lodging Association Educational Institute v. CBDT* [2006] 206 CTR (Delhi) 601/ [2007] 289 ITR 46 (Delhi). In this case, the assessee NGO was a branch office of an American NGO. It was not doing any charitable activity in India and all its income in India was repatriated to USA.

2.4.2 The Supreme Court was of the opinion that exemption under Section 10(23C) was not available if all the activities were outside India though Section 10(23C) does not specifically make it mandatory that the activities be done in India. In other words, the Supreme Court opined that NGOs registered under Section 10(23C) should primarily have activities in India to claim exemptions. The Court observed that the absence of words "in India" does not automatically imply "anywhere in the world". In the light of this ruling, it may be concluded that NGOs registered under Section 10(23C)(vi) are also required to have activities in India only; however, in the light of the observation of the Supreme Court they may have some activity outside India as there is no specific bar on working outside India under Section 10(23C)(vi).

2.4.3 Therefore, one needs to distinguish between an NGO registered under Section 12A and Section 10(23C), the former cannot have any activity outside India, without prior permission of CBDT, but the latter may have some activity outside India because Section 10(23C) is silent about the location of activities and the Supreme Court opined that such NGOs should primarily be working in India. Therefore, in either case, to avail tax exemptions in India, the dominant purpose and activity should remain inside India.

INCOME SHOULD NOT ONLY BE APPLIED FOR CHARITABLE PURPOSES BUT ALSO APPLIED IN INDIA

2.5.1 In the case of*Director of Income-tax (Exemption) v. National Association of Software & Services Companies* [2012] 21 taxmann.com 213 (Delhi), the High Court of Delhi held that the income of the trust should not only be applied for charitable purposes, but also applied in India to such purposes. In other words, it was held that it was not permissible to incur funds outside India, even for charitable purposes beneficial to India. The implication of this decision is that an expenditure cannot be made outside India, for example an NGO cannot medically treat a person outside India. Or it cannot import medicine from outside India but can buy imported medicine from a dealer in India.

SUPPORTING STUDENTS TO STUDY OUTSIDE INDIA

2.6.1 In case of *Jamsetji Tara Trust v. Joint Director of Income-tax (Exemption) Range-II* [2014] 44 taxmann.com 447, Mumbai Tribunal held that education grant given to Indian students for studying abroad fulfils conditions of application of money in order to claim exemption under Section11.

WILL ACTIVITIES OUTSIDE INDIA RESULT IN FORFEITURE OF ENTIRE INCOME?

2.7.1 It may be noted that if an NGO, registered under Section 12A incurs expenditure outside India in contravention of Section 11(1)(c), then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption. The provisions of Section 11(1)(c) do not attract forfeiture over the entire income unlike the provisions of Section 13(1). In other words, if an NGO is willing to pay taxes to the extent of its activities outside India, then to that extent it can have such activities. The total forfeiture of income is not possible because applying funds outside India has not been envisaged as a reason for forfeiture under Section 13(1)(a) to 13(1)(d). In the case of *CIT v. State Bank of India* [1988] 169 ITR 298 (Bom.), the trust had applied income outside India and the income to that extent only was subjected to tax.

WILL A CLAUSE OF ACTIVITIES OUTSIDE INDIA IN THE TRUST DEED INVITE FORFEITURE?

2.8.1 If there is a clause in the trust deed which provides for activities outside India, it would not disentitle the organisation from claiming exemption. ***The provisions of Section 11(1)(c) are attracted only if actual expenditure is incurred outside India. Section 11(1)(c) cannot be invoked only on the ground that the trust deed provides for activities outside India.***

2.8.2 In the case of *CIT v. State Bank of India* [1988] 169 ITR 298 (Bom.), one of the issues was whether a trust for charitable purposes in India and abroad can claim exemption from its income where the trustees have discretion to apply the income either in India or abroad? The trust deed provided, at the discretion of the trustees, to give 45 per cent of the income to the University of Athens. It was held that the trust was eligible for exemption even though it provided for application of income abroad. However, the portion of income actually applied abroad or accumulated for application abroad was not exempt.

2.8.3 Similarly, in *CWT v. Trustees of the Nizam's Religious Endowment Trust* [1977] 108 ITR 229 (AP), it was held that the charitable or religious expenditure incurred in India will not be affected by a provision for activities outside India or even actual expenditures abroad. Exemptions towards activities in India remain intact and in the case of a clause in the trust deed empowering the trust to have activities outside India, there is no impact. In the case of trust having activities outside India, the exemption will be denied to the extent of the income applied outside India.

2.8.4 Further, it has been held that only the existence of other objects can not affect the charitable status of a Trust or NGOs in the case of *Digamber Jain Society for Child Welfare v. DGIT (Exemptions)* [2010] 228 CTR (Delhi) 517. In the case of *Ewing Christian College Society v. Chief CIT* [2009] 318 ITR 160 (All.), it was held that the objective to serve the church and nation would not mean that the society was not existing solely for educational purposes; therefore, any additional object clauses normally should not affect the charitable status of a trust or NGO.

TRANSFER OF FCRA FUNDS TO OTHER COUNTRIES

2.9.1 In the light of the discussions made in this chapter, it becomes important to discuss whether FCRA funds could be transferred to other countries. In this context, it should be noted that the transfer of funds to other countries should be distinguished into 2 categories:

i. Transfer of funds by an NGO to its own overseas branch or project;

ii. Transfer of funds to NGOs of other countries;

2.9.2 Generally Indian NGOs are not permitted to have activities or branches outside India. Therefore, having branches and transferring FCRA funds is not permissible, in general.

2.9.3 Foreign Contribution Act, 2010 (FCRA) is silent regarding expenditure to be incurred in foreign country or activity outside India. However, the Charter for NGOs provided by FCRA department specifically states that activities outside India cannot be conducted with FC Funds, the Charter for NGOs is provided in **Annexure-2.** Further, it specifically provides that if the funds are transferred to another NGO, it can be given only to another FC registered NGO. For transfer of funds, in India, to NGOs not registered under FCRA prior approval under Rule 24 is necessary. The FCRA Act has not envisaged the possibility of transferring funds to NGOs in other countries and therefore, without any exception it bars the transfer of FC funds to NGOs which are not registered under FCRA, particularly outside India.

2.9.4 It is advisable to seek permission from FCRA Department to work outside India. FCRA Department may provide specific or general permission u/s. 50 of the Foreign Contribution Regulation Act, 2010 (FCRA). Once the exemption is received then only FC fund should be used for activities outside India.

DELHI HIGH COURT RULING

2.10.1 In the case *Director of Income-tax (Exemption) v. National Association of Software & Services Companies* [2012] 21 taxmann.com 213 (Delhi) the High Court of Delhi High Court held that the income of the trust should not only be applied for charitable purposes, but also applied in India to such purposes. It was observed that the interpretation that the words 'in India' qualifies only the words 'such purposes' would not only be contrary to the plain grammatical meaning of Section 11(1)(a) but also render the provisions of Section 11(1)(c) redundant and otiose. The interpretation of the words 'in India' qualifies only the words 'such purposes' would not only be contrary to the plain grammatical meaning of Section 11(1)(a) but also render the provisions of Section 11(1)(c) redundant and otiose. If it was accepted that income of trust can be applied even outside India so long as the charitable purposes are in India, then there is no need for a trust which tends to promote international welfare in which India is interested and was created on or after 1-4-1952 to apply to the CBDT for a general or special order for exemption. The relevant extract is as under:

"If, as we have explained in the preceding paragraph, grammatically also the group of words as they exist in the clause are to be understood as expressing the requirement that the income of the trust should be applied in India to charitable or religious purposes, then even if we were to relocate the words "in India" in the manner in which Mr. Vohra says that we are doing, it would make no difference to the -meaning to be ascribed to the group of words. Perhaps in that case the meaning would have been brought out in still more precise or clear terms but there are different ways of expressing the requirement that the income of the trust should be applied in India in order to get exemption and even if we were to assume that the language used in the clause is not sufficiently expressive of the idea, sitting here we should be able to set right and construe the provision in the manner in which it makes sense, unless by construing the words in the manner in which we have done, there results an absurdity which cannot be countenanced at all. We have earlier referred to the judgment of the Supreme Court in H.E.H. Nizam's Religious Endowment Trust (supra) wherein it was observed that though before 1.4.1952 there was no requirement as to the territorial limits within which the income should be applied to charitable purposes, after 1.4.1952 the position was different since the

government perhaps thought that it could not forego the revenue where the, income of the trust is not actually applied within the territorial limits of India. This was the result of the amendment made by the Income Tax (Amendment) Act, 1953 w. e. f. 1.4.1952 when Section 4(3)(i) of the old Act was recast to bring out clearly the territorial limits within which the incomeof the trust needs to be applied in officer to secure exemption. Thus whatever might have been the position prior to 1.4.1952, it is clear that after that date it was not the intention of the 'legislature to forego the tax as well as the benefits arising out of the application of income of the trust within the' territorial limits of India. The position has remained unchanged from 1.4.1952 for at least 60 years now. Therefore, it cannot be said that by construing Section 1l(1)(a) in the manner, that the requirement therein is that the income of the trust should be applied in India for charitable or religious purposes, we are doing any violence to the provisions nor can it be said that we are condoning an absurd result."

2.10.2 The High Court interpreted the natural grammatical meaning of the words "to the extent to which such income is applied to such purposes in India" appearing in Section 11(1) (a) of the Act. The High Court observed that the word "applied" is a verb in the past tense used in a transitive form followed by words "such purposes" and "India" qualified with two prepositions "to" and "in". This being the case, the words should be read as applicable to charitable purposes and also applied in India to such purposes.

2.10.3 The assessee's contention, that "in India" qualifies only the phrase "such purposes" so that only the purposes are geographically confined to India, was not acceptable to the High Court. The Court observed that if such meaning was assigned to the words, it would disturb the natural or grammatical interpretation of the words, "to the extent to which such income is applied to such purposes in India". For this purpose, the Court relied on a few Rules of interpretation laid down in the cases of *Jugal Kishore Saraf v. Rao Cotton Co. Ltd*. AIR 1955 SC 376*; Kanai Lal Sur v.Paramnidhi Sadhukhan* AIR 1957 SC 907 and *Union of India v. Rajiv Kumar* [2003] 6 SCC 516.

2.10.4 *The implication of this decision is that an expenditure cannot be made outside India, for example an NGO cannot medically treat a person outside India. Or it cannot import medicine from outside India but can buy imported medicine from a dealer in India.*

2.10.5 The words used in Rule 4(4) of the Companies CSR Rule, 2014 are *"the CSR projects or programs or activities undertaken in India only shall amount to CSR Expenditure".* It can be noted that the emphasis is on activities undertaken in India therefore, any programmatic activities which may enhance an Indian cause, shall not be considered as CSR activities if undertaken outside India. In that context, the above Delhi High Court ruling is relevant and companies should avoid spending or undertaking activities outside India.

Annexures - 1

DOCUMENT REQUIRED TO BE FURNISHED WHILE SEEKING EXEMPTION U/S 11(1)(C) OF THE INCOME-TAX ACT, 1961

1. Certified Copies of Trust Deed, Articles of Association, Memorandum of Association (as applicable) and PAN Card
2. Copy of order granting registration u/s 12AA of the Income Tax Act
3. Amount in INR and year in which it is proposed to be remitted/ incurred
4. In case money is to be remitted, a note on the purpose for remitting the money giving the details of remittee and the manner in which the sum remitted is generally proposed to be utilized
5. Copies of the latest IT Return along with Account Statements
6. Copy of the latest Assessment orders, if any in last five years
7. Details of pending prosecution launched by Income Tax Department, if any
8. Details of any proceeding initiated/pending for violation of FCRA regulations, if any

The applicant may give his e-mail id, phone number, fax number and complete address for correspondence.

Annexure - 2

CHARTER FOR ASSOCIATIONS WHO HAVE BEEN GRANTED PRIOR PERMISSION OR REGISTRATION UNDER FCRA

- An association granted prior permission or registration under the repealed Foreign Contribution (Regulation) Act, 1976 shall be deemed to have been registered or granted prior permission, as the case may be, under the Foreign Contribution (Regulation) Act, 2010 (FCRA, 2010) and such registration shall be valid for a period of 5 years from the 1st May, 2011, i.e., up to the 30th April, 2016.
- Every certificate of registration granted under FCRA, 2010 shall be valid for a period of five years from the date of its issue.
- Every certificate of registration shall have to be renewed. The application for renewal is to be made in Form FC-5 along with the prescribed fee, six months before the date of expiry of the certificate of registration. An association implementing an ongoing multi-year project shall apply for renewal twelve months before the date of expiry of the certificate of registration. In case no application for renewal of registration is received or such application is not accompanied by the requisite fee, the validity of the certificate of registration shall be deemed to have ceased from the date of completion of the period of five years from the date of the grant of registration.
- An association granted prior permission or registration under the Foreign Contribution (Regulation) Act, 2010 (FCRA, 2010) should receive the foreign contribution in the same exclusive designated Bank Account mentioned in the order granting prior permission or registration. This account number would be the same as has been intimated by the organisation in their application for prior permission/registration. Deposit of any local fund in this bank account is not allowed. One or more accounts in one or more scheduled banks may be opened for utilizing the foreign contribution provided that no funds other than foreign contribution shall be received or deposited in such account or accounts. Section 17 of the FCRA, 2010 may please be referred.
- Foreign contribution cannot be mixed with local funds being handled by the organisation.
- **An association granted prior permission or registration is required to carry out the activities, for which foreign contribution is received, in India only and the amount should not be utilised for purposes other than for which it is received.**
- Any fixed asset acquired out of the foreign contribution and any article received in kind from the foreign source should be in the name of the association and not in the name of any individual in the association.
- Not more than 50% of the foreign contribution shall be defrayed to meet administrative expenses of the association. What constitutes 'administrative expenses' has been defined in Rule 5 of the Foreign Contribution (Regulation) Rules, 2011 (FCRR, 2011).
- Any foreign contribution or any income arising out of it shall not be used for speculative business. What constitutes 'speculative business' has been defined in Rule 4 of FCRR, 2011.
- An association granted prior permission or registration should maintain a separate set of accounts and records, exclusively for foreign contribution received and utilised. If the foreign contribution relates only to articles, the intimation shall be submitted in Form FC-7. If the foreign contribution relates

to foreign securities, the intimation shall be submitted in Form FC-8. Every report submitted shall be duly certified by a chartered accountant.

- Every account giving details of the receipt and purpose-wise utilisation of the FC, including the interest earned on the FC amount, should be maintained on an yearly basis, commencing on the 1st day of April each year, and every such yearly account is to be submitted, in prescribed Form FC – 6 along with the income and expenditure statement, balance sheet and statement of receipt and payment, duly certified by a chartered accountant in duplicate, within nine months of the closure of the year, i.e., before 31st December. Every such return in Form FC-6 shall also be accompanied by a copy of a statement of account from the bank where the exclusive foreign contribution account is maintained by the person, duly certified by an officer of such bank. The cash book and ledger account on double entry basis, where the FC relates to currency received and utilised. The annual return in Form FC-6 shall reflect the foreign contribution received in the exclusive bank account and include the details in respect of the funds transferred to other bank accounts for utilisation.
- The accounting statements shall have to be preserved by the NGO/ association for a period of six years.
- Even if no FC is received during a year, a 'Nil' return is required to be filed with the Ministry of Home Affairs within the prescribed time limit.
- Associations/NGOs granted registration or prior permission, which have received foreign contribution in excess of one crore rupees, or equivalent thereto, in a financial year, shall place the summary data on receipts and utilisation of the foreign contribution pertaining to the year of receipt as well as for one year thereafter in the public domain.
- No FC should be transferred to an association which has not obtained either prior permission or registration under FCRA or to any person or association, prohibited under FCRA from receiving any FC. However, if the foreign contribution is proposed to be transferred to a person who has not been granted a certificate of registration or prior permission by the Central Government, the person concerned may apply for permission to the Central Government to transfer a part of the foreign contribution, not exceeding ten per cent, of the total value of the foreign contribution received. The application shall be countersigned by the District Magistrate having jurisdiction in the place where the transferred funds are sought to be utilized. The District Magistrate concerned shall take an appropriate decision in the matter within sixty days of the receipt of such request from the person. The donor shall not transfer any foreign contribution until the Central Government has approved the transfer. Any transfer of foreign contribution shall be reflected in the returns in Form FC-6 as well as in Form FC-10 by the transferor and the recipient.
- Change of name, address, registration, nature of activities or aims and objectives of an association should be intimated to the Ministry of Home Affairs within 30 days of effecting the change, along with the documentary evidence effecting the change.
- Prior permission of Ministry of Home Affairs should be obtained for replacing 50% or more of the office bearers.
- Prior permission of Ministry of Home Affairs should be obtained for changing bank account for valid and convincing reasons.

3. PERMISSIBLE CSR ACTIVITIES & SCHEDULE VII

INTRODUCTION

3.1.1 The Section 135 and the Companies (CSR) Rules, 2014 provide that specific activities have to be conducted under CSR. Further, Schedule VII has been provided which elaborate the specific activities.

3.1.2 Section 135(3)(a) provides that the activities should be undertaken by the company as specified in Schedule VII. On plain reading of Section135 it seems that no other activities other than the one specified in Schedule VII are permissible.

3.1.3 However, Rule 2(c) defines that Corporate Social Responsibility shall not be confined to the projects and programmes specified in Schedule VII therefore, if one goes by the definition of CSR then all kinds of charitable activities are permissible and Schedule VII is just an indicative list.

3.1.4 Under the current enacted Rules it seems that there would not be any violation if a company conducts legitimate charitable activities even beyond the list provided in Schedule VII. However, it could be legally debated whether a Rule can supersede the Act because Section 135(3)(a) clearly provides that the CSR activities should confine to Schedule VII.

PERMISSIBLE CSR ACTIVITIES AS PER SCHEDULE VII

3.2.1 The various activities permissible under CSR as per Schedule VII are as under:

i. Eradicating hunger, poverty and malnutrition, promoting health care including preventive health care and sanitation ***including contribution to the Swach Bharat Kosh set-up by the Central Government for the promotion of sanitation*** and making available safe drinking water;

ii. Promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, & the differently abled and livelihood enhancement projects;

iii. Promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups;

iv. Ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water ***including contribution to the Clean Ganga Fund set-up by the Central Government for rejuvenation of river Ganga***;

v. Protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts;

vi. Measures for the benefit of armed forces veterans, war widows and their dependents;

vii. Training to promote rural sports, nationally recognized sports, paralympic sports and Olympic sports;

viii. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socioeconomic development and relief and

welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women;

ix. Contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government;

x. Rural development projects

CSR ACTIVITIES AS PER SECTION 135

3.3.1 The various activities to be conducted under CSR are referred twice in Section 135. In Section 135(3)(a), it is mentioned that the CSR activities should be as per Schedule VII. And again in Section 135(4)(b) it is mentioned that the Board should ensure that the activities as per the CSR policy are undertaken by the company. The text of Section 135(3) & (4) is provided as under:

(3) The Corporate Social Responsibility Committee shall,—

a. formulate and recommend to the Board, a **Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in ScheduleVII**;

b. recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and

c. monitor the Corporate Social Responsibility Policy of the company from time to time.

(4) The Board of every company referred to in sub-Section (1) shall,—

a. after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and

b. **ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.**

3.3.2 The provisions of Section 135 as stated earlier specifically refer to activities mentioned in Schedule VII. This is contrary to the definition of CSR under the CSR Rules which state that CSR activity shall not be limited to the activities mentioned in Schedule VII.

CSR ACTIVITIES AS PER CSR RULE

3.4.1 The Companies (CSR) Rules, 2014 defines CSR in terms of the CSR activities. The definition of CSR is very broad and states that it is not limited to the activities mentioned in Schedule VII.

3.4.2 Further, the Companies (CSR) Rules, 2014 explains CSR activities in terms of the methodology and exceptions. The elaboration of CSR activities and the exception have been made without mention of Schedule VII. Only in the definition of CSR policy under Rule 2(1)(e) a reference to ScheduleVII has been made.

3.4.3 Under the current enacted Rules it seems that there would not be any violation if a company conducts legitimate charitable activities even beyond the list provided in Schedule VII. However, it could be legally debated whether a Rule can supersede the Act because Section 135(3)(a) clearly provides that the CSR activities should confirm to Schedule VII. However, if a company is following the enacted Rules, it cannot be punished, even if the Rules are not consistent with the Act.

4. UNDERSTANDING CSR ACTIVITIES CHARITABLE PURPOSE

INTRODUCTION

4.1.1 As discussed in the last chapter that the Companies (CSR) Rules, 2014 provide a broad interpretation to the various activities which can be conducted under CSR. Therefore, it becomes important to understand the meaning of the term 'charitable' in the common parlance as well as in the legal context. In this chapter, the various interpretations and nuances of the term 'charitable purpose' has been discussed.

THE TERM 'CHARITABLE' IS VERY BROAD

4.2.1 NPOs are generally known as charitable organisations, the term charitable is too broad to include various diverse categories on organisations, the term charitable includes: -

- Organisations engaged in scientific, cultural, social activities etc.;
- Religious organisations, though for Income Tax purposes religious organisations should specifically work for religious purposes only;
- Organisations doing activities without having philanthropic activities i.e. having activities with reasonable profit. For instance, schools which survive on the fees collected from students are treated as 'charitable' even if they are making reasonable profit;
- Even organisation such as stock exchanges and chambers of commerce have been considered as charitable organisation.

4.2.2 The bottom line for being a charitable organisation is to apply all its income and resources for its declared objectives without distributing any surplus to members or related persons or parties.

DEFINITION OF CHARITABLE PURPOSE AND CHARITIES ACT, 2006 OF UNITED KINGDOM

4.3.1 "Charitable Purpose" generally implies working for the benefit of the poor and downtrodden, however legally the definition is very broad to include various other activities which may not be towards benefit of the poor. Each country has a separate definition of "Charitable Purpose". Generally, the charitable purpose is very broad and covers wide range of objectives including benefit of animals, trade associations, farmer associations, religious bodies, etc.

4.3.2 In this regard, it is worthwhile to refer the Charities Act, 2006 of United Kingdom which provides a very exhaustive definition of the term "charitable purpose" which is as under:

a. The prevention of relief of poverty;
b. The advancement of education;
c. The advancement of religion;
d. The advancement of health or the saving of lives;
e. The advancement of citizenship or community development;
f. The advancement of the arts, culture, heritage or science;
g. The advancement of amateur sport;
h. The advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;

i. The advancement of environmental protection or improvement;
j. The relief of those in need, by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
k. The advancement of animal welfare;
l. The promotion of the efficiency of the armed forces of the Crown or of the police, fire and rescue services or ambulance services;
m. Other purposes currently recognized as charitable and any new charitable purposes which are similar to another charitable purpose.

"CHARITABLE PURPOSE" UNDER INCOME TAX ACT, 1961

4.4.1 The amended definition of 'charitable purpose' under Section 2(15) under the Income Tax Act, 1961 is as under:

"charitable purpose" includes relief of the poor, education, yoga, medical relief, and the advancement of any other object of general public utility:

"Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless—

i. such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and

ii. the aggregate receipts from such activity or activities during the previous year, do not exceed twenty per cent of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year;"

4.4.2 The implication of the amendments can be summarised as under:

- It has been clarified that Charitable Organisations engaged in advancement of any other object of general public utility, can have incidental business activities to the extent of 20% of the total receipts. It will immensely help large organisations which were suffering because of the existing 25 lakh limit. However, there is no clarity whether the total receipt shall also include the business receipts to determine 20% amount and at the same time this may have impact on small NGOs which are presently getting a blanket limit of Rs.25 Lakhs irrespective of their total receipts.
- It has been clarified that Charitable Organisations engaged in advancement of any other object of general public utility, can have incidental business activities only if it pertains to advancement of their charitable objectives. This will create litigation and hardship for the seventh limb organisations i.e. Charitable Organisations engaged in advancement of any other object of general public utility, other organisations can have even unrelated incidental business activities in the light of the Supreme Court decision in the case of Asstt. CIT v. Thanti Trust [2001] 247 ITR 785, wherein it was held that if the income generated from a business of publishing newspaper is totally used for charitable purposes then such business should be considered as incidental. In this case, the assessee was having the business of publishing newspaper and the entire income was used for charitable purposes. In other words, newspaper publication itself is not a charitable purpose but can be held as an incidental business, subject to the provision of Sections 2(15) and 11(4A).

IV. GOVERNANCE

1. **DIFFERENT TRAITS AND TYPES OF BOARD**
2. **GOVERNANCE CONTROLS**

1. DIFFERENT TRAITS & TYPES OF BOARD

INTRODUCTION

1.1.1 All NPOs are created by people for human intervention in public causes. Therefore, each NPO and its board is distinct and unique. The boards of NPOs consciously or unconsciously take different forms and assume different attributes which may or may not serve the purpose of the organization. In this Section we will discuss the various peculiarities of board structures and the de facto reality of various boards and trustees, based on our study, experience and understanding.

BOARD FORMED IN 'FIDUCIARY' CAPACITY OR UNDER TRUSTEESHIP

1.2.1 The Trust form of registration was legislated for NPOs formed in fiduciary capacity or under trusteeship. In such model an individual or entity bequeaths its property or wealth for public purposes and appoints a group of person as trustees. Some attributes of such board are as under:

- Appointment of board or trustee is discretionary in nature, at the hand of the settler,
- Board of trustee are more like a guardian for an orphan child.
- Boards are closely held bodies and they work on the principle of loyalty towards the settler of the trust. They work towards fulfilling the promise which they give by becoming trustees.
- Boards have a top down orientation where the trustees work on a pre-determined mandate.

1.2.2 Such fiduciary boards are good for specific trusts but such models have severe limitations when they start working on resources generated from society at large. Further the long term institutional sustainability and transition of leadership always remains a matter of concern in such models.

FAMILY OR FOUNDERS BOARD

1.3.1 There are organizations including trust and society which are created by a particular family or an individual. In such organization, the board and governance is basically controlled by one family or an individual. Some peculiarities of such model is as under:

- Such organization has a board which comprises friends and relatives.
- The board of such organization sometimes may have eminent people from the society, who normally do not give time or interfere.
- Such organization normally becomes successful on the basis of the charisma, expertise or contacts of one individual or a family.
- Such organization is prone to misuse of resources and power by the board members.
- In such organizations, empowerment of staff and democratic decision making become difficult.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

FOUNDING MEMBERS BOARD

1.4.1 There are organizations including trust and society which are created by a particular group of individuals who may have common goal and vision for public purposes. In such organizations, the board and governance is basically controlled by the founding members. Some peculiarities of such model is as under:

- Such organizations have a board which comprises the founding group of members and their friends & relatives.
- The board of such organization sometimes may have eminent people from the society, who normally do not give time or interfere.
- Such organizations normally become successful on the basis of the charisma, expertise or contacts of the founding group of members.
- Such organizations sometimes turn out to the very effective in terms of governance and programmatic relevance. However, such effectiveness is dependent on the individual commitment of the founding members. From a systemic point of view, such models do not reflect shared ownership of all the stakeholders.
- Such organizations are prone to infighting and power struggle within the board members.
- Such organizations are prone to misuse of resources and power by the board members.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

CEO'S BOARD

1.5.1 There are organizations including trust and society which are controlled by the CEO or the Executive Director. Such organizations generally have a strong historical precedence and are generally created by formal institutions for specific or a larger cause. For instance, an Association of NPOs may be registered for a purpose or a donor may support in creation of an organization for definite public purposes. The board and governance is basically controlled the management and the executive head of the organization. In such an organization the board is initially identified by the founding institutions and later on it may be based on ex-officio position or rotation of eminent people of the society. Some peculiarities of such model is as under:

- Such organizations have a board which comprises of eminent people from the society who are invited to oversee the governance process.
- The members of board of such organizations are scattered and sometimes are ex-officio positions. Further, the CEO of the organization is relatively stable and the board may keep on changing. Therefore, the board may lack a strong sense of ownership and authority over the management.
- Such organizations normally become successful on the basis of the charisma and expertise or contacts of the Executive Director or the CEO.
- Such organizations sometimes turn out to the very effective in terms of governance and programmatic relevance. However, such effectiveness is dependent on the individual commitment of the CEO or Executive Director. From a systemic point of view such models do not reflect shared ownership of all the stakeholders.
- In such organizations the board sometimes becomes an ineffective formal structure which mostly relies on the inputs and directions provided by the CEO or Executive Director.

- Such organizations do not have a healthy governance structure as the staff and management become more powerful then the board.
- Such organizations are prone to misuse of resources and power by the CEO or Executive Director. Therefore, such organizations are strongly dependent on the charisma and values of the CEO or Executive Director.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

TOKEN BOARD

1.6.1 There are organizations including trust and society which are created for public purposes but the board and governance is basically controlled by people other than the actual board members.

1.6.2 ***Case Study:*** An NPO claimed that 100% of its board members were women from the target communities. However, in reality all these board members depended on the management of the organization, they were basically used to create an illusion of an accountable and participative model of governance. On verification of records it was found that the board members were entitled for bus fares and very modest accommodation in contrast to the entitlement of the staff that were entitled for travel by Air and accommodation in three star hotels. There were many other findings which made it apparent that the board members were marginalized beneficiaries only. Some peculiarities of such model is as under:

- Such organization have a board which comprises representatives from the target community.
- The members of board of such organizations stay away from the actual functioning of the organization and are invited only twice or thrice in a year. Further, the CEO of the organization is relatively stable and the board may keep on changing. Therefore, the board lack a sense of ownership and authority over the management.
- The board members depend on the CEO and management for various programme and entitlements which is a strong deterrent to their empowerment.
- Such organizations have a camoflaged board and from a systemic point of view such models do not reflect shared ownership of all the stakeholders.
- In such organizations the board in an ineffective formal structure which mostly relies on the inputs and directions provided by the CEO or Executive Director.
- Such organizations do not have a healthy governance structure as the staff and management become more powerful then the board.
- Such organizations are prone to misuse of resources and power by the CEO or Executive Director.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

INTERESTED PARTY BOARD

1.7.1 In corporate governance it is provided that all companies should have independent directors. However, in case of NPOs, each and every director is supposed to be independent i.e. they should not have any personal interest in the resources or functioning of NPO. However, the directors in an NPO are permitted to take reasonable remuneration and payment against any other goods and services rendered. In NPO, if majority the directors are taking remuneration, consultancy or have rented their premises etc., then such board is called an interested party board

as most of the board members are dependent on the NPO for some monetary consideration (even if it is legitimate) which may impair their ability to govern. Some peculiarities of such model is as under:

- Such organizations have a board which comprises people who are involved in the day to day activity.
- The board of such organizations depend on the organization for earning income for their personal purposes, therefore, if the number of such board members exceed more than 50% of the total boardthen the board does not remain independent
- Such organizations, sometimes, turn out to be the very effective in terms of governance and programatic relevance. However, from a systemic point of view, such models have little distinction between the management and the board.
- Such organizations are prone to compromises between the management and the board as both have individual interest at stake.
- Such organizations are prone to ineffective or misuse of resources and power by the board members.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

EMPLOYEES BOARD

1.8.1 In case of NPOs the, directors are permitted to take reasonable remuneration and payment against any services rendered. It has been seen that sometimes most of the board members draw salaries. In NPO, if majority the directors are taking remuneration, then such board is called an employee's board as most of the board members are dependent on the NPO for salaries (even if it is legitimate) which may impair their ability to govern. Some peculiarities of such model is as under:

- Such organization have a board which comprises people who are involved in the day to day activity.
- The board of such organizations depend on the organization for earning income for their personal purposes, therefore, if the number of such board members exceed more than 50% of the total board then the board does not remain independent.
- Such organizations sometimes turn out to be the very effective in terms of governance and programatic relevance. However, from a systemic point of view such models have little distinction between the management and the board.
- Such organizations are prone to compromises between the management and the board as both have individual interest at stake.
- In such organizations, an effective board does not exist and therefore it can be said that the organization is being governed by the employees.
- Employees are one of the most important stakeholders but such models of board may result in misuse of resources and power by the board members in favour of the employees.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remain a matter of concern.

ORNAMENTAL OR EMINENT BOARD

1.9.1 Many NPOs have a board comprising ofvery high profile individuals. There are NPOs whose board members are the "Who's Who" of the society. Such boards are highly

impressive sheerly because of the quality and eminence of the board members. Some peculiarities of such model is as under:

- Such organizations have a board which comprises people who are not involved in the activity of the organization.
- The board of such organization does not internalise the work of the organization because such member may not have the time to be involved in the organization.
- Such organizations may be very effective in terms of governance and programatic relevance. However, from a systemic point of view such models have very little *de facto* role of governance for the board.
- The board of such organizations is generally endorsive in nature. However, due to the quality of the people involved enduring and strategic decision are generally well taken.
- Such organizations may not have an effective board for the oversight function over the management.
- Such organizations rely heavily on the CEO and Executive Committee for the normal functioning of the organization.
- Such boards do not reflect a true representation of the various stakeholders. Such boards should be balanced with people from other Sections of stakeholders.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern, as the organization generally survives based on the executive systems.

POLITICAL BOARD

1.10.1 Many NPOs have a board comprising of individuals from cross Section of stakeholders and members. There could be NPOs where the members may come from the geographical spread, for instance one board member from each district. Or a national level NPO may have state bodies as members and board members may come from each state. When the board is formed as a result of nominations/election based on pre-determined Sections whether geographical or otherwise, such board are called political boards. National association of professionals and other national bodies are examples of such NPOs. Some peculiarities of such model is as under:

- Such organizations have a board which comprises people who are not involved in the activity of the organization at the governance level. Such people generally work at a functional or divisional level of the organization. Therefore, the board members are prone to their individual divisional interest or the interest of the constituency they represent.
- The board of such organization is too involved and internalises with most of the work of the organization because such member may be involved at various levels in the organization.
- Such organizations may be very effective in terms of governance and programatic relevance. However, from a systemic point of view such models have very little *de facto* independence in the role of governance for the board.
- The board of such organizations is generally compromising in nature. Normally members belonging to powerful groups and constituencies influence the decision making process.

- Such organizations may not have an effective board for the oversight function over the management. The board is involved in the execution and the CEO and the management staff may not be empowered enough.
- In such organizations the voting power and number game becomes important and as a result the interest of the marginal stakeholders may suffer.
- Such boards provide a true representation of the various stakeholders, however it is difficult in such model to have independent board members who do not have any interest in the decision making process.
- In such organizations, also, the long term institutional sustainability and transition of leadership is not a matter of concern, as the organization generally survive based on the membership and organizational structure.

EX OFFICIO OR NOMINATED BOARD

1.11.1 Many NPOs have a board comprising of individuals who are nominated by various institutions. There are NPOs whose general members are mostly institutions and various government bodies. The institutional members generally nominate members to the board. In such NPOs the board members are the Ex-officio nominations from various institutions and government bodies. Such boards are artificial in nature as the board members get appointed only because of a position they are otherwise holding. Some peculiarities of such model is as under:

- Such organizations have a board which comprises people who are not involved in the activity of the organization.
- The board of such organization does not internalize with the work of the organization because such member may not have the time to be involved in the organization.
- Such organizations may be very effective in terms of governance and programmatic relevance. However, from a systemic point of view such models have very little *de facto* role of governance for the board.
- The board of such organizations are generally endorsive in nature and the governance is largely dependent on the executive team.
- Such organizations may not have an effective board for the oversight function over the management.
- Such organizations rely heavily on the CEO and Executive Committee for the normal functioning of the organization.
- Such boards may reflect a true representation of the various member organizations. However, such boards should be balanced with people from other Sections of stakeholders.
- In such organizations, the long term institutional sustainability and transition of leadership may not be a matter of concern, as the organization generally survives based on the membership structure and executive systems.

2. GOVERNANCE CONTROLS

INTRODUCTION

2.1.1 Not-for-Profit Organizations (NPOs) are made up of people who share common values, a vision for future and a commitment towards fulfilling its purpose of existence. In view of the above, the Governing Body of NPOs play a crucial role in casting the vision and translating the vision into action. The primary role of the governing mechanism is derived from the legal and statutory requirements articulated at the time of its legal incorporation. The overall statutory requirements from the Governing Body are in terms of ensuring effective management, audit and the reporting of its program and activities to its constituencies/stakeholders. As the apex policy making body of the organization, it should ensure that effective policies are in place to guide the organization towards its goals in a systematic way. Finally, one of the most important roles of the Governing Body is to ensure accountability of the leadership of the Organization to which they delegate their authorities. John Carver's 'Policy Governance Model' needs a special mention here. According to John Carver, *"Policy Governance refers to a governance system that enables boards to focus on ownership (moral or legal), the future of the organization and its own governance processes, while empowering the CEO and his/her staff to manage the organization within* ***pre-defined boundaries****. The system strengthens the organization through board adoption of a comprehensive set of policies and protects the organization through board monitoring of policy compliance".* Therefore, it is essential for the Board to ensure accountability of the leadership of the organization through appropriate **'Governance Controls'**.

WHY IS IT IMPORTANT TO ENSURE ACCOUNTABILITY OF THE LEADERSHIP?

2.2.1 Les Stahlke & Jennifer Loughlin, in their book 'Governance Matters' have talked about seven deadly sins of organizations which have the potential to affect the core processes of the organizations. One of the deadly sins as described by them is **'Weak Governance, Leadership & Management'** which will eventually lead to poor quality & inefficiency in service delivery of the organization. In fact, weak governance leads to ineffective leadership & poor management. On the other hand, a governance mechanism that ensures accountability of the leadership helps in establishing efficient leadership and eventually effective delivery of services to the beneficiaries.

- **Ownership Vs Trusteeship:** An organization is an artificial legal entity (artificial person) separate from its members. Thus, an organization can sue and be sued in its own name; has its own rights and duties; can enter into contractual relations of its own accord; own properties of its own distinct from its owners and so on. When in certain cases, this concept of an organization's artificial personality is abused or misused, the judiciary has the right to disregard the corporate identity and **'lift the corporate veil'**. The usage of the concept has acquired various names like 'lifting the curtain', 'piercing the veil', breaching the wall of the corporation' etc. 'Lifting the Corporate Veil' describes a legal decision where a shareholder or director of a corporation is held liable for its debts or liabilities of the corporation despite the general principle that shareholders are immune from suits in contract or tort that otherwise would hold only the corporation liable. This doctrine is also known as 'disregarding the Corporate Entity'.

  Thus, the judiciary may on its own accord crack open the corporate shell in circumstances it deems fit in the interest of justice. Now the circumstances

under which the Corporate Veil can be lifted are many. Some of them are:

i. Reduction of the number of members below minimum
ii. Misdescription of the Company's name
iii. Fraudulent Conduct
iv. Evasion of tax
v. Contempt of Court
vi. Fraud

The circumstances given above are some of the situations in which the Corporate Veil may be lifted. There are many other such circumstances in which the Corporate Veil may be lifted. This device merely seeks to strike a balance between the interests of the public and the concept of a separate entity and is desirable in certain cases to ensure accountability of the organization.

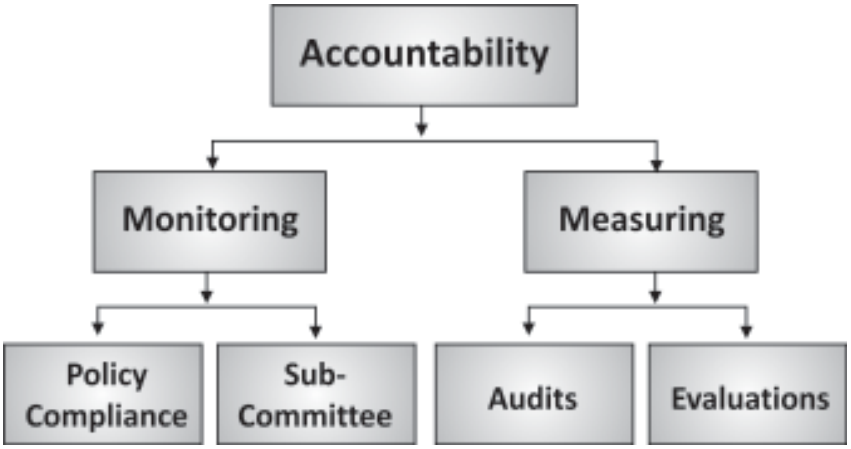
Now, let us try to draw a parallel here in the Not-for-Profit Sector. An NPO primarily operates on the basis of donation and grants received. The fund on which NPOs primarily operate is for a specific purpose and the NPO is merely a custodian of the funds & the Governing Board, on behalf of the NPO is entrusted with the task of carrying out a specific development activity or activities. Therefore, trust plays a crucial role in the operation of the Not-for-Profit organizations. Since the Board is entrusted with the task governing the organization, parallel can be drawn from corporate practices regarding **'lifting of the Corporate Veil'**. Therefore, it is the primary obligation of the Board to ensure that the organization operates in a free and fair manner & is serving the purpose for which it was created.

- **Derived Authority Demands Accountability:** The authority of the Chief functionary of an NPO is a derived one. The Board assigns him/her with the authority as well as the responsibility of managing the organization. Thus it follows that the Chief functionary is accountable to the Board for his/her performance & conduct. Accountability of the Chief Functionary plays the crucial role of balancing the authority that rests with him/her.

HOW CAN IT BE DONE?

2.3.1 It is now clearly understood that it is extremely important for the Board to ensure the accountability of the leadership. But the question that emerges at this juncture is how the Board goes about it or to put it in other words, what are the basic 'Governance Controls' in the context of Not-for-Profit Organizations?**Monitoring &Measuring** are the two components of the Accountability Process. Therefore, the Governance controls in any organization should address these two components.

GOVERNANCE PROCESS



2.3.2 In the context of Not-for-Profit Organizations, the four basic areas through which accountability of the leadership can be ensured are:

- Policy Compliance
- Sub-Committees
- Audit
- Evaluations

2.3.3 ***The areas of policy compliance & sub-committees take care of the component of monitoring whereas the areas of audits & evaluations involve the component of measuring.*** Together, they would ensure the accountability of the leadership of the organization. Each of these areas will be dealt with in greater detail in the succeeding Section.

- **Policy Compliance:** a governing board is a board that controls the organization through policies rather than managing the daily affairs of the organization. The Chief Functionary should operate & function within the policy framework set by the Governing Board of the Organization. In general, the policy framework should include;

  i. **Finance Policy:** The finance policy of an NPO can include its travel, payment, support documentation, advance, investments, and audit policies of the organization.

  ii. **Program Policy:** The program policy should include the key objectives stated in the vision & mission of the organization and the activities planned to achieve them.

  iii. **Human Resource Policy:** This would include personnel recruitment, staff appraisal, staff salary, staff welfare schemes like P.F, Gratuity etc.

  iv. **Administrative Policy:** The administrative Policy should include the details of maintenance & use of office equipments, leave procedures, internal discipline & overall office management. It is the responsibility of the chief Functionary to adhere to the policy framework and prepare a report on the policy compliance. The policy compliance report should be submitted to the Board along with the supporting evidence. This would ensure that all the policies set by the Board are being complied with. If not, the reasons for doing so have to be explicitly stated in the report. Apart from the Chief Functionary, the Policy Compliance Report should be signed by two other employees of the leadership level.

- **Sub Committees:** The idea behind forming sub-committees is to delegate some of the Board's authority & responsibility to various small groups. A committee may also be formed to handle a specialized management function that the board decides not to delegate to the Chief Functionary. Sometimes, committees are also formed to mirror the work of the organization. They are designed to monitor management decisions and to maintain a familiarity with the daily issues the organization faces. Such committees are helpful in keeping the board members more closely informed on the changing environment in which the organization is operating. Some of the common sub committees are finance committee, board development committee, advisory committee etc. It has to be ensured that some of the board members are part of these sub-committees. This will help them monitor the work of the committees from close quarters & help the board to be abreast with developments therein.

- **Audits:** An audit is an independent assessment of the fairness by which an organization's financial statements are presented by its management. Audits are performed to ascertain the validity and reliability of information and also provide an assessment of an organization's internal control. It is important to recognize that it is the board which is primarily responsible for the preparation of financial statements. The duty of the auditor is to express his/her opinion on the financial statements. The audit report should be submitted to the Board with a Management Letter.

  Apart from the mandatory statutory audit, the board should also ensure regular Internal Audits. Internal Audits are not statutory. The internal audit keeps a check on the systems of the organization. The internal audit report should be presented to the Board of the Organization. This would provide a clear view of the internal state of affairs. It would be advisable if the internal audit is not conducted by the auditor who conducts the mandatory external audit.

- **Evaluations:** Evaluation in the context of development work refers to a systematic and objective assessment of an on-going or completed operation, program or policy, its design, implementation and results. Any evaluation should aim to assess or measure the relevance, effectiveness, impact, efficiency, sustainability &replicability of the concerned development program.

  The effectiveness of evaluation as a tool lies in its vast scope. Evaluations can cover financial, programmatic, governance as well as administrative aspects of an organization's operation. An evaluation that covers all these aspects would provide a holistic view of the organization's work and operation. In other words, evaluations of development programs & projects is basically about describing, judging and explaining what has been done, how activities have been performed, what has been achieved and what should be the future course of action. It is the primary responsibility of the Board to have evaluation at regular intervals. This would act as a reality check and provide a clear picture of the organization's standing vis-à-vis its vision & mission. However, an evaluation should not be seen as a threat by the Board but as an opportunity to have an independent external view of the organization.

CONCLUSION

If a Board truly chooses to govern, then it will delegate the authority to the Chief functionary for managing the organization while setting the boundaries through appropriate policy framework. Because the board's governance function is distinct from the staff's management function, the board must determine its own definition of governance and then decide how it will actually govern. All board members should clearly understand why the board exists; the purpose is not to oversee staff but rather to define the future on behalf of the moral ownership and to ensure that the future is achieved in a legal, ethical, and prudent manner. The board must be accountable for its own performance & make the leadership of the Organization accountable for their performance. Some of the tools to ensure accountability of the leadership are already mentioned in the article. Apart from these, there are other tools like Appraisals, interaction with Staff & other stakeholders that can be used for ensuring the effective functioning of the organization.

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