

# Standards & NORMS

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## IMPACT OF FINANCE ACT 2008 ON BUSINESS ACTIVITIES OF NGOS

(Revised Edition after Explanatory Circular dated 19.12.08)

### CONTENTS

Overview of the Amendments from a Layman's Perspective	1
Changes made by Finance Act, 2008 w.e.f. 01.04.2009	3
Explanatory Circular Issued by CBDT	3
Consultancy Income Whether Commercial or Business	4
2008 Amendments are Softer than the 1961-1984 Position	5
Explanatory Statement and Legal Intent	5
Charitable Purpose, Business Activity and Profit Motive	6
Profit is no longer a Relevant Factor	7
Supreme Court in Thanthi Trust and Gujarat Maritime Case	7
Business Purpose Vs Actual Business Activity	8
NGOs having mixed charitable purposes	8
The process of loosing charitable status	9
Steps to be taken by NGOs	9
Concluding Remarks	10
Text of the Circular on Charitable Purpose	11

### OVERVIEW OF THE AMENDMENTS FROM A LAYMAN'S PERSPECTIVE

**1.1** The Finance Act, 2008 w.e.f. 1-4-2009 has amended the definition of 'charitable purpose' under section 2(15) which may have far reaching ramifications, a brief overview of the resulting scenario is as under :

**1.1.1** The definition of 'charitable purpose' can be divided into 4 parts, viz. (i) relief of poor, (ii) education, (iii) medical relief, (iv) advancement of any other object of general public utility. However, the Finance Act, 2008 w.e.f. 1-4-2009 has excluded any trade, commerce or business related activity by any trust or NGO engaged in the fourth category i.e. advancement of any other

object of general public utility, from the purview of 'charitable purpose'. In other words an NGO exclusively engaged in the field of education, medical relief and relief of poor shall not be hit by this amendment.

**1.1.2** Therefore, w.e.f. 01.04.2009 it seems that income from trade, commerce or business pertaining to those NGOs which are coming under the fourth category of 'charitable purpose' shall not be treated as charitable activity and the entire exemption of such Trust will be lost. Consequently such organisations will not be eligible for any exemption under section 11 or other provisions which provide exemptions towards charitable purpose. It may be noted that the issue of incidental activity of business will not be relevant to such group of NGOs whether the business activity

is incidental or not, shall be of no consequence, as this fourth category of NGO will lose the charitable status.

**1.1.3** There is a confusion that only the business income of NGOs shall become taxable at the rate of 30%. It is clarified that once an NGO is hit by this provision it will lose its charitable status and the entire income will become taxable.

**1.1.4** It is pertinent to note that all other NGOs (other than the NGO coming under the fourth category) can have business related activity as permitted under section 11(4A), and other provisions pertaining to business activities shall be applied without any changes.

**1.1.5** Hitherto the law was very liberal with regard to the business activities of NGOs and even income from unrelated businesses (for example, publishing newspapers) held by them was eligible for exemption if the entire income was used for charitable purposes. The law will continue to remain liberal for the first three categories of NGOs.

**1.1.6** It is important to note that the exclusion of trade or business related activities is discriminatory and will apply to only a particular group of NGOs or Trusts as discussed above. It is not clear why a particular group of NGOs will be discriminated even though the registration provides an *on par* status to all NGOs. The resulting scenario denotes an unfair legal situation where even an incidental business activity of the fourth category NGO will render forfeiture of the charitable status. On the other hand, for other NGOs even unrelated business activities might be permissible. The constitutional validity of such unfair provision needs to be verified.

**1.1.7** Newly inserted proviso to section 2(15) lays down the 'specified activities'. They are :

- Carrying on of any activity in the nature of trade, commerce or business (hereafter referred to as 'the trade'); or
- Carrying on of any activity of rendering any service in relation to the trade, for a fee or cess or any other consideration.

The proviso further lays down that if the

***It is clarified that once an NGO is hit by this provision it will lose its charitable status and the entire income will become taxable.***

specified activities are carried on in pursuit of the fourth object, then it would not be considered as a charitable purpose.

**1.1.8** It may be noted that NGOs or trusts engaged in the fourth objective shall continue to be eligible under section 11 unless they engage in trade or business related activity.

**1.1.9** It may also be noted that the current amendments are prohibiting business activity and not *profit making*. In other words such fourth category NGOs may still have some profit through various sources of income generation other than business or commercial activity. Therefore, going by various case laws activities such as charity shows, rent from property or conferences facilities, etc shall still be permissible and valid. The CBDT has issued an explanatory circular in this regard which is annexed herewith. The circular categorically denies even incidental business or commercial activities for the fourth category NGOs. Therefore, even incidental business activities such as marketing products of the beneficiaries or greeting cards etc, on a regular basis, shall endanger the charitable status.

**1.1.10** Other charitable organisations such as chamber of commerce, professional associations, etc may also be affected by the amended provisions. Now onwards association of similar persons or entities including Chamber of Commerce may have to be distinguished in terms of mutuality and charitable activities. The aforesaid circular recommends exemptions on grounds of mutuality if any commercial activities are happening within the members. In such case charitable status cannot be claimed even though the income will be exempt from tax. The said circular complicates the legal status of bodies like Chamber of Commerce, Port Management etc, because their activity, *per se*, are considered as charitable

activities, therefore, if some surplus are generated in the normal course of their operations should not be affected by the amendments.

**1.1.11** All Trusts or NGOs pursuing the fourth objective need to analyse their activities and find out the activities for profit, if any, related with business, trade or commerce. The normal legal precedence is to make the law effective from the first day of the Assessment Year, therefore, when the Act says *w.e.f.* 01.04.2009 then the implication is that all business activities need to be stopped *w.e.f.* 1.4.2008 to retain the status as charitable organisation. In this context it may be noted that the Finance Act was passed in the month of May 2008 and therefore, for the current year there is no option provided to the NGOs to take remedial measures if the law becomes effective from 01.04.2008. The intent of the statute could not have been to impose this provision retrospectively without providing any opportunity for remedial measures. Normally the amendments apply from the beginning of the Assessment Year, but since this change is in the definition of *charitable purpose*, the applicability, in our opinion, should be from 01.04.2009 because the old definition of charitable purpose will remain effective till 31.03.2009. A suitable clarification from the government/CBDT is necessary in this regard.

#### **CHANGES MADE BY FINANCE ACT, 2008 W.E.F. 1-4-2009**

**1.2** The Finance Act, 2008 *w.e.f.* 1-4-2009 has amended the definition of 'charitable purpose' under section 2(15) and consequently certain specific group of NGOs will not be allowed to have any business activity whether incidental or otherwise, the amended section is as under : "charitable purpose" includes relief of the poor, education, 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;

***In other words,  
profit making is  
still permissible provided  
it should not come from  
activities related with  
trade business and  
commerce.***

**1.2.1** The proviso in italics above has been inserted by the Finance Act 2008. In effect the above amendment has excluded the residual category of trusts from carrying on any kind of trade or business related activities.

#### **EXPLANATORY CIRCULAR ISSUED BY CBDT**

**1.3** The CBDT has recently issued an explanatory circular dated 19.12.2008 No. 11/2008, F. No. 134/34/2008-TPL. The circular is annexed herewith. The summary of the circular is as under.

**1.3.1** The circular reiterates the intent behind the amendment which is to deprive entities engaged in commercial activities from claiming exemption under the ground that such activities are for the advancement of objects of general public utility.

**1.3.2** The circular reaffirms that only the fourth category NGOs shall be affected. The other three category of NGOs can have incidental business activity.

**1.3.3** The circular further states that the fourth category NGOs can not have even incidental business activity, which is contrary to the explanation provided in the first para i.e. to deprive entities engaged in commercial activities. This position taken by CBDT seems to be in violation of article 14 of the Constitution which does not permit generalised discrimination. Because the fourth category of NGOs is the residual category and all NGOs other than the first three category shall fall in it, therefore, it cannot be considered

as a specific class to be discriminated. Moreover, the intent of the amendment is to stop commercial entities from claiming tax exemptions but the result is that all the genuine NGOs are also denied incidental business activities which are permissible for the first three category of NGOs.

**1.3.4** The circular further provides that industry and trade associations who undertake business or trading amongst the members then their income shall be exempted under the principles of mutuality. If such organisations enter into commercial activities beyond members then the new amendments shall apply accordingly.

**1.3.5** The circular says that whether an entity is carrying an activity in the nature of trade or commerce shall be decided based on the nature, scope, extent and frequency of the activity. Therefore, it seems the Assessing Officer has to consider whether the entity as a whole is commercial in nature and charitable status shall not be lost even if there are some casual, infrequent, marginal activities of commercial nature.

**1.3.5** The circular fails to provide clarity about the implications of the amendments. It further reflects the confusions at the end of the CBDT which may be summarised as follows :

- The intent is to deprive commercial entities from claiming tax exemptions under the garb of a charity. However, all NGOs falling under the largest and the residual category, whether genuine or not cannot have even incidental and integral business activity for example, selling the goods produced by beneficiaries in a development programme.
- The authorities have made a blatant error by assuming that commercial entities are misusing the charitable status only as the fourth category NGOs engaged in advancement of any other public utility. However, the fact remains that rampant commercialisation is happening through educational and medical institutions. Therefore, such short-sighted amendment is either politically motivated or a wrong step in the right direction.
- It provides a new dimension to the process of determining business or commercial activities. As the question whether an

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***Whether an entity is carrying an activity in the nature of trade or commerce shall be decided based on the nature, scope, extent and frequency of the activity.***

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entity is carrying commercial activity shall be based on the nature, scope, extent and frequency of the activity. Such open ended provisions will only create more avenues of harassment, controversies and litigations.

#### **CONSULTANCY INCOME WHETHER COMMERCIAL OR BUSINESS**

**1.4** Another relevant issue is whether the consultancy income of NGOs derived in the course of their normal charitable work shall be construed as commercial activity or not. Going by the various judicial pronouncements it seems that consultancy income should not be considered as a part of business or commercial activities. It has been held that business includes 'commerce' which can be distinguished from 'trade'. In *Gannon Dunkerley & Co. (Madras) Ltd. vs. State of Madras (1958) 9 STC 353 (SC)* the Supreme Court has held that :

“in ordinary parlance trade and commerce carry with them the idea of purchase and sale with a view to make a profit. If a person buys goods with a view to sell them for profit it is an ordinary case of trade. If the transactions are of a scale it is called commerce. Further, a continuous repetition of such transactions constitute a business.”

**1.4.1** Consultancy is more a professional exercise based on intellectual capital and expertise, therefore, since only the words business, trade and commerce are used in this particular amendment, it seems that the consultancy income of NGOs shall not get affected. It may also be noted that this amendment unlike the earlier amendments is not against activity of profit by NGOs.

## 2008 AMENDMENTS ARE SOFTER THAN THE 1961-1984 POSITION

1.5 The current amendment in some sense are taking the law back to the legal position of the period between 1961 to 1984. It may be noted that when the act was enacted in 1961 the definition of charitable purpose stood as under :

"Charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility *not involving the carrying on of any activity for profit.*

1.5.1 The words '*not involving the carrying on of any activity for profit*' were added in 1961 which were not there in the 1922 act. Secondly, the words were added only to the fourth limb of the definition of the charitable purpose. In other words, only the activities towards advancement of general public utility should not involve carrying on any activity for profit. For the other three limbs medical, education and relief to poor profit making activity was permissible. This position was again reverted back to 1922 level by the amendments made by the Finance Act 1983 w.e.f. 1-4-1984 when the words '*not involving the carrying on of any activity for profit*' were omitted and the fourth limb i.e. advancement of general public utility was brought on par with the other three limbs of the definition of charitable purpose.

1.5.2 Now the current amendment has brought back the legal position to a period prior to 1-4-1984. As a matter of fact, on a strict analysis the current amendments are in a diluted form because the words '*not involving the carrying on of any activity for profit*' have not been re-enacted. In other words, profit making is still permissible provided it should not come from activities related with trade business and commerce.

1.5.3 In the past, various types of income making activities have not been held as business activities such as *Charity Shows* or *rental income from property* or even *Printing and Selling new year cards*. Such income should still be considered permissible to the extent they are not commercial in nature, even after this amendment which was not possible prior to 1-4-1984.

*The stated legal intent is to deny exemption of purely commercial and business entities which wear a mask of a charitable organisation.*

## EXPLANATORY STATEMENT AND LEGAL INTENT

1.6 The stated legal intent is to deny exemption of purely commercial and business entities which wear a mask of a charitable organisation. It needs to be seen to what extent these amendments prove appropriate in context of the intended objectives. The memorandum explaining the provisions of the Finance Bill, 2008, read as under :

1.6.1 "Section 2(15) of the Act defines 'charitable purpose' to include relief of the poor, education, medical relief, and the advancement of any other object of general public utility. It has been noticed that a number of entities operating on commercial lines are claiming exemption on their income either under section 10(23C) or section 11 of the Act on the ground that they are charitable institutions. This is based on the argument that they are engaged in the 'advancement of an object of general public utility' as is included in the fourth limb of the current definition of 'charitable purpose'. Such a claim, when made in respect of an activity carried out on commercial lines, is contrary to the intention of the provision.

1.6.2 With a view to limiting the scope of the phrase 'advancement of any other object of general public utility', it is proposed to amend section 2(15) so as 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 –

- (a) any activity in the nature of trade, commerce or business, or
- (b) any activity of rendering of any service in

relation to any trade, commerce or business for a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or the retention of such income, by the concerned entity.

**1.6.3** It is also worthwhile to note the following relevant extracts from the reply of the Finance Minister to debate in the Lok Sabha on 29-4-2008 on Finance Bill, 2008 :

"6, Clause 3 of the Finance Bill, 2008 seeks to amend the definition of 'charitable purpose' so as to exclude 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 or use of application, or retention, of the income from such activity. The intention is to limit the benefit to entities which are engaged in activities such as relief of the poor, education, medical relief and any other genuine charitable purpose, and to deny it to purely commercial and business entities which wear the mask of a charity..... I once again assure the House that genuine charitable organisations will not in any way be affected. The CBDT will, following the usual practice, issue an explanatory circular containing guidelines for determining whether an entity is carrying on 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. Whether the purpose is a charitable purpose will depend on the totality of the facts of the case. Ordinarily, Chambers of Commerce and similar organisations rendering services to their members would not be affected by the amendment and their activities would continue to be regarded as "advancement of any other object of general public utility."

#### **CHARITABLE PURPOSE, BUSINESS ACTIVITY AND PROFIT MOTIVE**

**1.7** In the light of the amendments made by the Finance Act, 2008 w.e.f. 1-4-2009 it has become imperative to carefully understand the differences and implications of the scope of charitable purpose, business activity and profit motive. The legal scenario in this regard could be as under :

***Though under section 11(4A) only incidental business activity is allowed, but there is a strong judicial precedence including Supreme Court rulings where even unrelated businesses held as property of the trust are treated as incidental***

**1.7.1** A particular class of NGOs will lose their recognition as a charitable organisation if they have any activity in the nature of trade, commerce or business irrespective of whether it is incidental activity or not. The NGOs coming under this category are those which are pursuing advancement of any other object of general public utility. Therefore, section 11 to 13 will not apply to such NGOs.

**1.7.2** Business or trade activities of other NGOs pursuing any of the three objectives (i) relief of poor, (ii) education, (iii) medical relief will not affect the charitable nature of such NGOs and therefore, section 11 to 13 will apply accordingly. Though under section 11(4A) only incidental business activity is allowed, but there is a strong judicial precedence including Supreme Court rulings where even unrelated businesses held as property of the trust are treated as incidental provided the entire income is applied for charitable purposes. Ironically, the amendments made by The Finance Act, 2008 w.e.f. 1-4-2009 do not seem to be affecting this position and eligible NGOs shall enjoy a *status quo* as far as the law pertaining to business income is concerned.

**1.7.3** In the definition of 'charitable purpose' the words "*not involving the carrying on any activity for profit*" were deleted by The Finance Act, 1983 w.e.f. 1-4-1984. Therefore, business or profit making activity *per se* are not excluded from the overall scope of charitable purpose. But the debate still remains that 'profit motive' and 'activity

for profit' are two different notions and the existence of the former may affect the charitable nature of the NGO, and therefore, may also endanger the exemptions available under section 11. In a recent case *Vodithala Education Society v. ADIT (Exemptions) II, Hyderabad* : [2008] 20 SOT 353 (HYD.) it was held that assessee had collected money over and above fee prescribed by concerned authority for admission of student, such an amount of capitation fee was a clear case of sale of education by assessee and, therefore, it could not be considered as charitable institution under section 2(15) because the purpose of the organisation as a whole was to make profit.

**1.7.4** Satisfying the criteria of 'charitable purpose' is the fundamental pre-requisite for the purposes of income-tax registration and availing the exemptions under section 11 of the Income-tax Act, 1961. The amendment made by The Finance Act 2008 will have wide implication on a large number of Trusts and NGOs which are coming under the fourth arm of 'charitable purpose' i.e. *the advancement of any other object of general public utility*. Now onwards the scope and interpretation of the clause *the advancement of any other object of general public utility* shall become one of the most important issue as far as the taxation and exemption of Trusts and NGOs is concerned.

**1.7.5** Further it should be noted that section 11(1), under which NGOs get exemptions, envisages a NGO wholly for charitable purposes. Therefore, if any portion of its activity does not satisfy the definition of charitable purpose, then the entire income will be subjected to tax.

## **PROFIT IS NO LONGER A RELEVANT FACTOR**

**1.8** The words "*not involving the carrying on of any activity for profit*", were not there in the 1922 Act and were added for the first time only when the new Act was enacted in 1962, and after 22 years, these words were again deleted by Finance Act, 1983, w.e.f. 1-4-1984 consequently, the old legal position was restored, i.e. profit making was no longer considered as a prohibited activity. The profit generated by a charitable organisation shall not, in principle, affect its charitable nature. However, if the motive primarily is to generate profit, then the

***In a recent case it was held that assessee had collected money over and above prescribed by concerned authority for admission of student, such an amount was to be classified as capitation fee and it could be said that assessee's case was a clear case of sale of education by assessee***

charitable nature can be questioned. As discussed earlier in this chapter in *Vodithala Education Society v. ADIT (Exemptions) II, Hyderabad*: [2008] 20 SOT 353 (HYD.) it was held that assessee had collected money over and above prescribed by concerned authority for admission of student, such an amount was to be classified as capitation fee and it could be said that assessee's case was a clear case of sale of education by assessee and, therefore, it could not be considered as charitable institution under section 2(15) because the purpose of the organisation as a whole was to make profit.

**1.8.1** Even after the amendments of 2008, the existence of profit shall not affect any NGO including the aforesaid fourth category NGOs. But if there is an outright motive to earn profit then it can be questioned and all category of NGOs may lose exemptions. And if there is a business activity then only the fourth category of NGOs will lose exemption.

## **SUPREME COURT IN THANTHI TRUST AND GUJARAT MARITIME CASE**

**1.9** In the case *Asstt CIT Vs Thanti trust (2001)247 ITR 785(SC)*, the Supreme Court had given a landmark decision wherein it was held that if the income generated from a business 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.

**1.9.1** The delicate issue to understand here is that newspaper publication as a charitable activity is not permissible, but if such business is held as a property under trust, then it is permissible. The Finance Act, 2008 w.e.f. 1-4-2009 has made a very fundamental change by excluding a group of Trusts from engaging into trade and business related activities. Therefore, those trusts which are pursuing the fourth category of objects under 'charitable purpose' i.e. advancement of any other object of general public utility are debarred from having any trade or business related activity. The issue to understand here is that a particular group of trusts or NGOs have been excluded *ab initio* (that is from the very beginning) before section 11(4) or (4A) become relevant.

**1.9.2** Therefore, in our opinion the legal and judicial position (as taken in *Thanti case*) should remain intact as far as the business or trade related income is concerned, even after the amendments made by Finance Act, 2008 w.e.f. 1-4-2009. The controversy is around the nature of charitable purpose which a trust is pursuing if it does not fall in the category of (i) relief of poor, (ii) education, (iii) medical relief, then any trade or business related activity whether incidental or not shall result in revocation of the entire exemption.

**1.9.3** Therefore, after this amendment if *Thanti Trust* is having activities which falls in the fourth category i.e. *advancement of any other object of general public utility* then it will no longer be considered as a charitable organisation. Similarly, in a recent case *CIT vs. Gujarat Maritime Board* [2008] 214 CTR (SC) 81, 295 ITR 561 (SC) it was held that the income earned and deployed for the development of the minor ports in India was a charitable activity and therefore, the Gujarat Maritime Board would continue to remain a 'charitable trust'. Now after the amendment if *Gujarat Maritime Board* is holding independent business activity whose profit feed the charitable work then the exemption will be lost. On the other hand if some profits are generated during the normal course of its charitable activity, then its charitable existence will remain intact. Because

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***Even if the  
fourth category NGO  
has in its objectives  
a clause pertaining to  
business activities,  
then also the provisions  
of section 2(15)  
will be attracted***

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*Gujarat Maritime Board* is clearly a fourth category charitable organisation. The same analysis will be different for a medical, educational or an NGO engaged in relief for poor, who are not hit by the recent amendments.

#### **BUSINESS PURPOSE VS ACTUAL BUSINESS ACTIVITY**

**1.10** It should be noted that the amendments have been made in the section defining charitable purpose, therefore, even if the fourth category NGO has in its objectives a clause pertaining to business activities, then also the provisions of section 2(15) will be attracted. In other words, NGOs need to amend their object clause and delete the business related clauses from their Memorandum of Association or Trust Deeds to avoid the attraction of section 2(15). Because there will be a possibility of questioning the charitable nature of an NGO even if it does not have any actual business related activities.

#### **NGOs HAVING MIXED PURPOSES**

**1.11** In the case of NGOs having mixed purposes e.g. working both on education and advancement of any other public utility, even if a small portion of the activity falls in the fourth category of charitable purpose the recent amendments will be attracted which means the NGO stands to lose its Income Tax exemption.



## THE PROCESS OF LOSING CHARITABLE STATUS

**1.12** The explanatory circular has been released but there is no clearcut guideline regarding the legal process through which an NGO would lose its charitable status. It seems that once section 2(15) is violated, the NGO automatically loses its charitable status. But nothing has been spelt out regarding providing an opportunity of being heard. Further the circular states that commercial activities shall be determined on the basis of frequency, nature, quantum, etc. which leaves a lot of room for controversies and different interpretations.

**1.12.1** Under section 12AA(3) the Commissioner of Income Tax (CIT) has the power to cancel the registration if the activities are not genuine or not being carried out in accordance with the objects of the trust. The provision of Section 12AA(3) is as under :

*Where a trust or an institution has been granted registration under clause (b) of sub-section (1) and subsequently the Commissioner is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, he shall pass an order in writing cancelling the registration of such trust or institution:*

***Provided** that no order under this sub-section shall be passed unless such trust or institution has been given a reasonable opportunity of being heard.*

**1.12.2** The section does not specifically cover the situation where the objects cease to remain charitable from a particular date. This is an anomaly because a valid charitable organisation deserves an opportunity of being heard before its charitable status is revoked.

**1.12.3** Therefore, NGOs may face hardship during assessment itself where the income tax officer may treat them as Association of Person (AOP)/ individual assessee subject to normal tax on the entire income. That will be possible only if it is conclusively settled that the NGO is engaged in business activities or its object clause contain activities involving business, trade and commerce.

*There is no clearcut guideline regarding the legal process through which an NGO would lose its charitable status*

## STEPS TO BE TAKEN BY NGOs

**1.13** All NGOs should verify the object clause as per the Memorandum of Association or the Trust Deed, if there is any clause about carrying on business activities then such clause should be amended.

**1.13.1A** separate organisation should be floated for carrying on business activities, even if such activities are incidental to the purposes of society.

**1.13.2** Going by the statute and various case laws, activities such as

- Consultancy income
- rent from properties
- income from conference halls
- income from one time activities such as charity shows, etc.
- professional service related with expertise incidental to charitable work, etc

shall not be considered as business income, provided such incomes are either non commercial or are occasional, for instance, conference facilities used for charitable purposes being rented out occasionally or in the case of renting out properties the NGOs does not start constructing properties for the purposes of renting out. Or consultancy income shall not be with regard to services towards any activity of trade, business or commerce. In the absence of clearcut guidelines and judicial precedence it is difficult to conclusively determine what is commercial and what is not.

## CONCLUDING REMARKS

**1.14** The recent amendments seem to be arbitrary and unfair towards genuine NGOs working at the grassroots. The problem in our country is that the same set of law apply for all categories of NGOs, right from a village level organisation to a national level organisation. This amendment may affect huge organisation like Board for Control of Cricket in India (BCCI) and at the same time it may also impact a small Gandhian NGO which works on the principle of Swaraj and manufactures and sells indigenous products.

**1.14.1** The authorities have made an blatant error by assuming that commercial entities are misusing the charitable status only as the fourth category NGOs engaged in advancement of any other public utility. However, the fact remains that rampant commercialisation is happening through educational and medical institutions.

**1.14.2** It provides a new dimension to the process of determining business or commercial activities. As the question whether an entity is carrying commercial activity shall be based on the nature, scope, extent and frequency of the activity. Such open ended provisions will only create more avenues of harassment, controversies and litigations.

**1.14 .3**It is very important that immediate remedial statutory measures are taken. For instance, the Government may consider exempting, say, incidental business income upto 5 or 10 lakh per year which will save thousands of genuine NGOs from possible harassment. Further depriving one whole class of NGOs only under an apprehension that there are certain commercial organisations in disguise of NGOs, defies natural justice and the constitutional validity of such amendment needs to be questioned. Particularly because the residual category of NGOs have been treated as a specific class for discrimination.

## **CIRCULAR ON CHARITABLE PURPOSE' UNDER SECTION 2(15)**

Circular No. 11/2008, F. No.134/34//2008-TPL  
Government of India, Ministry of Finance, Department of Revenue  
Central Board of Direct Taxes, (Tax Policy & Legislation Division)  
New Delhi, the 19th December, 2008

Definition of 'Charitable purpose' under section 2(15) of the Income tax Act, 1961 – reg. Section 2(15) of the Income Tax Act, 1961 ('Act') defines "charitable purpose" to include the following:-

- (i) Relief of the poor
- (ii) Education
- (iii) Medical relief, and
- (iv) the advancement of any other object of general public utility.

An entity with a charitable object of the above nature was eligible for exemption from tax under section 11 or alternatively under section 10(23C) of the Act. However, it was seen that a number of entities who were engaged in commercial activities were also claiming exemption on the ground that such activities were for the advancement of objects of general public utility in terms of the fourth limb of the definition of 'charitable purpose'. Therefore, section 2(15) was amended vide Finance Act, 2008 by adding a proviso which states that the 'advancement of any other object of general public utility' shall not be a charitable purpose if it involves the carrying on of –

- (a) any activity in the nature of trade, commerce or business; or
- (b) 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.

2. The following implications arise from this amendment –

2.1 The newly inserted proviso to section 2(15) will not apply in respect of the first three limbs of section 2(15), i.e., relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute 'charitable purpose' even if it incidentally involves the carrying on of commercial activities.

2.2. 'Relief of the poor' encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated under section 11(4A) or the seventh proviso to section 10(23C) which are that

- (i) the business should be incidental to the attainment of the objectives of the entity, and
- (ii) separate books of account should be maintained in respect of such business.

Similarly, entities whose object is 'education' or 'medical relief' would also continue to be eligible for exemption as charitable institutions even if they incidentally carry on a commercial activity subject to the conditions mentioned above.

3. The newly inserted proviso to section 2(15) will apply only to entities whose purpose is 'advancement of any other object of general public utility' i.e. the fourth limb of the definition of 'charitable purpose' contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or

business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

3.1. There are industry and trade associations who claim exemption from tax u/s 11 on the ground that their objects are for charitable purpose as these are covered under 'any other object of general public utility'. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants. Therefore, where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality. However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2 (15).

3.2. In the final analysis, however, whether the assessee has for its object 'the advancement of any other object of general public utility' is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of 'general public utility' will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible. Assessee, who claim that their object is 'charitable purpose' within the meaning of Section 2(15), would be well advised to eschew any activity which is in the nature of trade, commerce or business or the rendering of any service in relation to any trade, commerce or business.

(Pradip Mehrotra)  
Director (TPL-I)

Reference Book : **Taxation of Trust and NGOs with FCRA** by **Manoj Fogla**, published by TAXMANN Publications.

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