Standards & Norms

Resource support on NGO Governance, Accounting and Regulations

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BUDGET 2014 - CARROT & STICK FOR NGOs & TRUSTS

A joint initiative of fmsf VANI

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INTRODUCTION & SALIENT FEATURES

1.1.1 The innocuous looking Finance Bill, 2014 has brought some very far reaching and important amendments for the charity sector, particularly for those NGOs and Trusts which are availing tax exemptions under section 10(23C) and section 11.

1.1.2 Under the sub-clauses (iiiab) and (iiiac) to Section 10(23C) educational and medical institutions which are substantially funded by government are totally exempted. The Finance Bill 2014 has proposed to define the term "substantially funded" which shall be such percentage as may be notified.

1.1.3 The NGOs & Trusts which are registered or notified u/s. 11 or Section 10(23C) cannot claim the tax exemption under other provisions of section 10 i.e. except Section 10(23C). In other words, all otherwise exempted income shall also be subjected to 85% of application, earlier the Trusts & NGOs could transfer the entire amount of otherwise exempted income to corpus without applying for charitable/religious purposes during the year. This will not apply to agricultural income of the trust.

1.1.4 The contentious issues of whether double deduction of depreciation is permissible, has been laid to rest. The Finance Bill, 2014 proposes that depreciation will not be considered as application of income if the assets on which depreciation is charged has already been considered as a part of application of income, earlier.

1.1.5 There is a clarifying amendment with regard to the computation of tax liability in case of Anonymous Donations. It is proposed that while computing the tax liability of the total income instead of excluding entire amount of anonymous donation only the amount in excess of 5% of total income or Rs.1.00 lac whichever are higher should be deducted.

1.1.6 There is a great relief for NGOs & Trusts applying for registration under section 12AA; hitherto they were allowed tax exemptions only from the financial year in which the application for registration is made. The Finance Bill, 2014 proposes to exempt past assessment years where the assessment proceedings are pending before the Assessing Officer on the date of registration, if the objects and the activities are the same which have been considered by the Commissioner while granting registration. Further no action under section 147 can be taken by the Assessing Officer, in such cases.

1.1.7 There has been considerable increase in the scope and powers of the CIT under section 12AA regarding cancellation of the registration under section 12AA. The Finance Bill, 2014 proposes that the CIT can initiate cancellation proceedings if any

violation under sub-section (1) of section 13 is found during the assessment proceedings. Such unfettered powers may cause undue hardship as explained below.

RETROSPECTIVE TAX EXEMPTIONS

1.2.1 The biggest take away for the NGO sector is the retrospective tax exemption after 12AA registration. There is a great relief for NGOs & Trusts getting registration under section 12AA; hitherto they were allowed tax exemptions only from the financial year in which the application for registration is made.

1.2.2 The Finance Bill, 2014 proposes to exempt past assessment years where the assessment proceedings are pending before the Assessing Officer on the date of registration, if the objects and the activities are the same which have been considered by the Commissioner while granting registration. Further no action under section 147 can be taken by the Assessing Officer, in such cases.

1.2.3 **Actually, the Finance Bill, 2014 restores the provisions back to 2007. Prior to 1-6-2007 the CIT had the power to condone the delay in filing of an application for registration under section 12AA.** The Finance Act, 2007 withdrew the power of CIT to condone the delay as a result if the application was filed after the said period, then the Chief Commissioner or the Commissioner could not condone the delay w.e.f. 1-6-2007. Therefore, the exemptions were available for the assessment year immediately following the financial year in which the application was made.

1.2.4 The omission of power to condone by the Finance Act, 2007 was a very irrational and retrograde amendment which caused hardship and litigations throughout the country. The CIT after granting the registration under section 12AA were directing the AO to open past assessment years under section 147 under the plea that the registration can only be prospective.

1.2.5 This is a much needed amendment and shall save the deserving NGOs & Trusts from needless financial hardship and scrutiny by the department. The proposed amendments are reproduced as under :

> 8. In section 12A of the Income-tax Act, in sub-section (2), the following provisos shall be inserted with effect from the 1st day of October, 2014, namely:––
>
> "Provided that where registration has been granted to the trust or institution under section 12AA, then, the provisions of sections 11 and 12 shall apply

in respect of any income derived from property held under trust of any assessment year preceding the aforesaid assessment year, for which assessment proceedings are pending before the Assessing Officer as on the date of such registration and the objects and activities of such trust or institution remain the same for such preceding assessment year:

Provided further that no action under section 147 shall be taken by the Assessing Officer in case of such trust or institution for any assessment year preceding the aforesaid assessment year only for non-registration of such trust or institution for the said assessment year:

Provided also that provisions contained in the first & second proviso shall not apply in case of any trust or institution which was refused registration or the registration granted to it was cancelled at any time under section 12AA."

SWEEPING POWERS OF CANCELLATION – PUNISHING TWICE FOR SAME OFFENCE

1.3.1 The amendment which could cause discomfort to NGOs and may result in more litigations in future, is the increase in power of this CIT to cancel 12A registration. There has been considerable increase in this scope and powers of the CIT under section 12AA regarding cancellation of the registration. The Finance Bill, 2014 proposes that the CIT can initiate cancellation proceedings if any violation under sub-section (1) of section 13 is found during the assessment proceedings. It is proposed to add a new sub-section (4) to the section 12AA. The proposed provision are as under :

9. In section 12AA of the Income-tax Act, after sub-section (3), the following sub-section shall be inserted with effect from the 1st day of October, 2014, namely:—

"(4) Without prejudice to the provisions of sub-section (3), where a trust or an institution has been granted registration under clause (b) of sub-section (1) 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 is noticed that the activities of the trust or the institution are being carried out in a manner that the provisions of sections 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of sub-section (1) of section 13, then, the Principal Commissioner or the Commissioner may by an order in writing cancel the registration of such trust or institution:

Provided that the registration shall not be cancelled under this sub-section,

if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner."

1.3.2 This amendment brings a fundamental shift in the regulatory and assessment power of the CIT. It may be noted that section 13 is the section under which NGOs and Trust loose tax exemptions only for a particular assessment year if they violate any of the provisions of section 13(1).

1.3.3 Just to remind the provisions of section 13(1) state that the exemptions of the assessee shall be forfeited if it is engaged in (a) any private religious purpose (b) provide benefit to any particular community or caste (c) provide benefit to interested persons (d) invest in violation of section 11(5).

1.3.4 The provisions of section 13(1) are in the domain of the Assessing Officer and there are various offences which are not punished with withdrawal of total exemptions. For example it has been held that if certain investments are made in violation of section 11(5) then only that portion of investment should be subjected to tax. In other words, the 'so called' violations of section 13(1) have already been adequately addressed with penalties in that section itself. The penalties may be total or partial withdrawal of exemptions. The matters under section 13(1) are assessment issues and the registration under section 12AA is given on fundamental and constitutional issues such as genuineness and the charitable or religious purpose. Therefore, bringing CIT to act upon an assessment issue which is already subject to punishment may create confusion and needless litigations. This provision should have been brought with a *caveat*.

1.3.5 In such circumstances providing sweeping powers to the CIT to cancel 12AA registration for any violation of the provisions of section 13(1) may not be a prudent idea. Such amendment should have come with a protective proviso clarifying the circumstances under which the CIT can cancel 12AA registration for any violation of the provisions of section 13(1) only if the assessee is a habitual offender under section 13(1), then the CIT may initiate cancellation proceeding. **The proposed amendment is creating an overlap between the powers of the AO & the CIT. It also proposes to punish the assessee twice for the same offence, once under section 13 and against under section 12AA.**

DOUBLE DEDUCTION OF DEPRECIATION

1.4.1 The contentious issues of whether double deduction of depreciation has been laid to

rest. The Finance Bill, 2014 proposes that depreciation will not be considered as application of income if the assets on which depreciation is charged has already been considered as a part of application of income, earlier. The proposed provision are as under :

> 7. In section 11 of the Income-tax Act, after sub-section (5), the following sub-sections shall be inserted with effect from the 1st day of April, 2015, namely:––
>
> "(6) In this section where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year.

1.4.2 There are many cases in various High Court both in favour and against allowability of double deduction of depreciation. In the past in many cases it was held that NGOs can claim double depreciation even if the entire cost of the asset was treated as application/expenditure in the year of purchase. The issue of allowing further depreciation, even if the entire cost of the asset has been allowed in the year of purchase, has always been a matter of debate in the light of the various contradicting case laws. In the case of *Commissioner of Income-tax v. Market Committee, Pipli* [2011] 238 CTR 103 (Punj. & Har.) was held that such deduction was permissible. The court was of the view that depreciation in case of trusts was not a double deduction as it was not an expenditure; it only reduced the percentage of funds available for charitable or religious purposes. The court declined to accept the applicability of the Supreme Court ruling in *Escorts Ltd. v. Union of India* [1993] 199 ITR 43. It may be noted that in Escorts case Supreme Court held that double depreciation was not permissible however, this ruling was in context of a commercial organisation where the facts and circumstances are different from an NGO. On the other hand there were other High Court decisions which were against allowing double deduction of depreciation including the decision of the Kerala High Court in the case of *Lissie Medical Institutions vs. CIT* 76 DTR (Ker) 372.

1.4.3 **The proposed provision regarding disallowing double deduction of depreciation seems to be a positive step but it may cause undue hardship to assessee due to the wrong accounting and disclosure policies.** For instance, many NGOs and Trusts show restricted grants as income and purchase of assets from such grant as application. The organisation which follows such practices will suffer from the proposed amendments. The correct method would be to treat restricted grants as legal obligations and therefore, any purchase of assets would not be required to be treated as application out of income during the year.

CONCLUDING REMARKS

1.5.1 Overall the proposed Finance Bill, 2014 is a mixed bag for the NGO sector where some much needed relief has been provided, in the shape of retrospective exemptions. It has the potential to create a threatening environment by providing unfettered powers of cancellation to the CIT under section 13(1) for violation where there is an existing penal provision is already in place. It rationalises various needless controversies and confusions pertaining to depreciation, anonymous donation etc.

Standards & Norms aims to provide relevant informations and guidance on NGO governance, Financial Management and Legal Regulations. The informations provided are correct and relevant to the best of the knowledge of the author and contributor. It is suggested that the reader should cross check all the facts, law and contents before using them. The author or the publisher will not be responsible for any loss or damage to any one, in any manner.

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