

# AuditAble

7. NPO Taxation under the proposed Tax Code - 1  
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The Government has unveiled a new Tax Code<sup>1</sup> this month, which has been welcomed by many, as a simplification. However, the draft Bill has also made major tax changes for NPOs.<sup>2</sup> All the provisions related to taxation of NPOs have been collected<sup>3</sup> at one place, in chapter IV. This chapter consists of 11 sections. Additionally, section 10, read with schedule VI and VII provides for exemption of selected organisations. Also, section 72, read with schedule XVI, sets out deductibility of donations to NPOs.

In this issue of AuditAble, we look at how the new code might affect your client NPOs.

## Overview of Changes

Attribute	Present Act	New Code
Defining Characteristic	Charitable Purpose	Permitted Welfare Activities
Regulated Religious Organizations	Exempt under section 11, with restrictions	Fully exempt under section 10
Location of Activities	Within India	Anywhere in the world
Contributions to Corpus	Exempt	Fully Deductible
Carry forward of unspent funds	Allowed	Taxable
Minimum Spending Requirement	85%	100%
Accumulation for 5 years	Allowed	Taxable
Tax Rate	30%	15%
Payments to key persons	Reasonable payments allowed	Reasonable payments allowed
Investment	Mutual Funds, Scheduled Banks etc.	Allowed in all forms, except associated concerns
Business activities for secular NPOs	Permitted if incidental to attainment of charitable objectives clause 1-5	Permitted if carried on in course of actual welfare activity for objects 1-5
Business activities for religious NPOs	Permitted for all if incidental to attainment of objectives	Permitted if carried on in course of actual welfare activity for objects 1-5
Unrelated Income-generating activities	Not allowed	Not allowed
Anonymous Donations	Taxable @ 30%	Not taxable
Donor Incentive	50% - 100% deductibility	50% deductibility

The Government has unveiled a new Tax Code this month, which has been welcomed by many, as a simplification.

## For Whom the Bell Tolls...



### Religious or Secular?

The present section 11 clearly refers to charitable and religious purposes. The new Chapter IV does not mention the word religious at all. Who is going to be covered under chapter IV then? This has been clarified on page A-33 of the Discussion Paper<sup>4</sup>:

*Non-profit organisations like scientific*

*research associations, news agencies, professional association, welfare fund, education and medical institutions, religious trusts, trade unions, etc. will be allowed concessional tax treatment. [Emphasis added]*

Thus, Chapter IV will cover all types of non-profit activity, including charitable, professional and religious activities.

### Form of Organisation

All forms of organisations can get the status of an NPO<sup>5</sup>. This also includes a trust set up within another organisation<sup>6</sup>.

### ID Proof for NPOs

However, the code lays down rigorous conditions for establishing whether an organisation is really an NPO<sup>7</sup>. Apart from the expected procedures such as registration and audit, there are tests related to intention, activities and application as shown in the table on the left:

There is also an important procedural change here. You will need to demonstrate each year to the ITO that you have actually carried out the permitted welfare activities. You will also need to prove that the general public has been the actual beneficiary. This may be difficult unless the ITO has been sensitised to the NPO sector.

Consider a situation where an NPO has been formed newly, and is yet to start welfare activities. However, it has started receiving income from investment of its Corpus. In such a case, the NPO will be denied tax exemption till the time it can show actual activities.

### Threshold of Tax

Presently, NPOs with income of less than Rs.150,000 annually do not have to register under sec. 12A or file a tax return or meet other exemption requirements.

The new Code apparently does away with this. Now each NPO has to register under section 93, irrespective of the level of income. They also need to comply with all the requirements of the Code<sup>8</sup>. If this is not done, it has to pay income tax as a society @ 30% on the total income<sup>9</sup>.

### Effective Date

The Hon. Minister has stated that the Code will be presented in the coming winter session. This means that it may become law by March 2010. But when will it become effective?

Sec. 1(3) states that the Code will come into force on 1<sup>st</sup> day of April, 2011. Sec. 2(7) says that tax for any financial year will be determined on the basis of provisions of the Code as on the following 1<sup>st</sup> April.

Does this mean that the tax for financial year 2010-11 will be calculated on the basis of this



Category	Tests
<b>Intention</b>	Established for: <ul style="list-style-type: none"> <li>• Public benefit</li> <li>• Permitted welfare activities</li> <li>• Not for a particular caste</li> <li>• Not for benefit of its members or interested persons</li> </ul>
<b>Reality</b>	<ul style="list-style-type: none"> <li>• Actual activities</li> <li>• Actual benefit to public</li> </ul>
<b>Interested Persons</b>	No direct or indirect benefit through: <ul style="list-style-type: none"> <li>• Expenditure</li> <li>• Funds or assets</li> <li>• Surplus</li> </ul>
<b>Application</b>	No investment in prohibited modes
<b>Documentation</b>	<ul style="list-style-type: none"> <li>• Maintains prescribed accounts</li> <li>• Registered as NPO under Tax Code</li> <li>• Audit report for permitted business</li> <li>• Audit report for welfare activities (if gross receipts &gt; Rs. 150, 000)</li> </ul>

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Code? The answer appears to be 'yes'. This would also be in line with the present practice where tax for a previous year is computed based on Income Tax provisions for the following assessment year.

However, there is also a different interpretation of sec. 1(3). According to this, the Code will apply only to the income for the financial year 2011-12 onwards. Hopefully, the correct answer will become evident when the Code becomes law.

### Key Changes

What are the key changes to the method of taxation that this code makes?

#### 1. Permitted Welfare Activities

The phrase 'charitable or religious purposes' will be replaced by 'Permitted Welfare Activities'. Thus, the emphasis of the law has shifted from 'purpose' to 'activities'. It has also been narrowed somewhat by the use of the word 'permitted'.

'Purpose' is defined as an objective, goal or end (Black, 1999). An apparently commercial activity, such as lending, could be charitable, if the objective is to provide relief to the poor. It is argued that 'purpose' is more subjective, and 'activity' is more objective. The use of the word 'activity' will give the tax authorities tighter control over this aspect.

While the sub-clauses of permitted welfare activities remain unchanged for the time being, the language has been modified. For instance, only an activity involving the relief of the poor will be a permitted welfare activity. Similarly, the phrase 'medical relief' has been narrowed to 'provision of medical relief'. 'Education' has been widened to 'advancement of education'. Most of the words and phrases have not been defined in the Code itself. In the next issue of *Auditable*, we discuss these in some detail, using other sources to understand their meaning.

...Continued in *Auditable* 8



### Bibliography:

Black. (1999). *Black's Law Dictionary* (7th ed.). (B. A. Garner, Ed.) St. Paul, Minnesota, USA: West Group.

<sup>1</sup> Direct Taxes Code Bill, 2009

<sup>2</sup> Defined in sec. 96(d): "non-profit organisation" means an organisation, by whatever name called, including a trust, if -  
(i) it is established for the benefit of the general public;  
(ii) it is established for carrying on permitted welfare activities;  
(iii) it is not established for the benefit of any particular caste;  
(iv) it is not established for the benefit of any of its members;  
(v) it actually carries on the permitted welfare activities during the financial year;  
(vi) the actual beneficiaries of its activities are the general public;  
(vii) it does not intend to apply its surplus or other income or

- use its assets or incur expenditure, directly or indirectly, for the benefit of any interested person;
- (viii) any expenditure by the organisation does not enure, directly or indirectly, for the benefit of any interested person;
- (ix) the funds or assets of the organisation are not used or applied or deemed to have been used or applied, directly or indirectly, for the benefit of interested person;
- (x) the surplus, if any, accruing from its permitted activities does not enure, directly or indirectly, for the benefit of any interested person;
- (xi) the funds or the assets of the non-profit organisation are not invested or held, at any time during the financial year, in any of the forms or modes specified in section 91;
- (xii) it maintains such books of accounts and in the manner, as may be prescribed;
- (xiii) it is registered as such under section 93; and
- (xiv) it obtains a report of audit in prescribed form from an accountant before due date of filing of the return in respect of,-
- (A) the accounts of business, if any, carried on by it in accordance with the provisions of section 84; and
- (B) its accounts relating to the permitted welfare activities in a case where the gross receipts referred to in section 89 exceeds one lakh fifty thousand rupees;
- <sup>3</sup> Section 87
- <sup>4</sup> Para 12.3(d)
- <sup>5</sup> Section 96(d)
- <sup>6</sup> Section 96(d), read with section 96(h)
- <sup>7</sup> Non-profit Organisation. This term has been defined for the first time in an Indian legislation.
- <sup>8</sup> Audit report is not required if gross receipts are less than Rs.150,000 during the year.
- <sup>9</sup> First Schedule, paragraphs B and C, read with section 93 and
- <sup>10</sup> 95
- Sec. 96(g): "permitted welfare activity" means any activity,-
- (i) involving the relief of the poor;
- (ii) for the advancement of education;
- (iii) for providing medical relief;
- (iv) for the preservation of environment including watersheds, forests and wildlife;
- (v) for the preservation of monuments or places or objects of artistic or historic interest; or
- (vi) for the advancement of any other object of general public utility;

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