Income Tax - Some Features

Speaker: Income Tax Registration Procedures, Exemption of Income; Accumulation and Investment; Forfeiture of Exemption; Business Activity of Charitable Organisation; Privileges under Section 80G – these are the 6 things we will look at.

First, the registration procedure – Within one year of the incorporation of the organisation apply in Form 10A to IT Commissioner or Director of Income Tax (Exemptions). There is a form in which you need to apply to the Commissioner of Income Tax.

You need to attach copy of the original instrument under which the NPO was registered. The original is not to be attached, a verified copy is attached. Later the original is shown to the Income Tax Commissioner to say that this is the original. Two copies of the accounts of the previous three years should be attached where ever applicable.

What has come to our observation during many of our workshops is that many NGOs have not even been registered with Income Tax for 20-25 years. The problem is if they go the Income Tax Department and start registering, they will require three years of accounts and so they will put in a demand of last three years with penalty. This becomes a catch 22 situation and it needs to be fought at the higher levels. There have been court cases where the courts have allowed retrospective registration.

Income Tax Department will allow registration prospectively; it cannot give you registration retrospectively. When you file your 10A, the accounts for last three years are picked and then taxes are applied on it along with penalty and interest and it comes up to a substantial amount. However, if this issue is fought in the court and there are cases where the income tax department has been forced to allow registration from the retrospective effect.

But the law doesn't allow, hence the Commissioner of Income Tax cannot allow retrospective registration. It is better if we get the exemption within the first year. Time limit is within first year of the incorporation of the organisation.

Audience: When the case was fought what was the court's stand?

Speaker: The high court allowed the retrospective registration and the department did not take it to Supreme Court, hence it resolved in HC itself. The problem is CIT is bound by the law and can only allow prospectively - it can say from today you are registered. The CIT being under the law has to charge penalty. So then if you fight it at higher levels, the courts allow it.

Six months from the date of application, the Income Tax Commissioner has to dispose off the application. The opportunity of being heard has to be given; and there is appeal possible against rejection. Suppose the commissioner rejects then you can go and appeal. There is no clarity if no order is not passed within the time limit. So there is no penalty at the end of the department if they don't pass the application. Normally it has not happened that the 10A application has not been passed on time.

Audience: In fact, there has been judgement only last week which said it is just a directory clause about this. That means if it is delayed beyond six months, it's merely a direction and it's not mandatory upon the CIT to dispose the application. Just last week I read in the reviews.

Speaker: Now we come to part of exemption. Types of Income –

1) Contribution to the corpus of the Trust;

2) Other contributions are donations;

3) Income from Business Activity;

4) Capital Gains.

So these are the four types of Income that normally a NGO can have. Corpus grant, corpus donation comes with directions from the donor, this we have discussed in our previous session. Suppose the donor says that we are contributing this much for the corpus of the organization and that doesn't fall under the 85 per cent application clause.

So you can retain 100 per cent of it within the organization, you do not have to spend anything. Secondly, other contributions or donation comes under the 85 per cent clause. So you have to spend 85 per cent of it, but we will see how and what are the clauses under that.

Income from Business activities - according to the new law in 2008, Section 2, subsection 15 was amended. It basically talks about charitable purpose. Charitable purpose said relief to the poor, education, medical and in 2008, any other activity of general public utility.

These are the four things said in the law. When the amendment came in 2008 it said, the first 3 is okay, they can do commercial activity but if you are involved in any other general public utility then you cannot do any commercial activity, under the fourth item. Now we must understand, unfortunately when you get a certificate under 12A, the certificate does not mention which category you are registered under, whether you are counted as relief to the poor.

So that is all determined in the objective of the organization. This led to a space where there can be a lot of confusion and counter claims. During the assessment, you have to prove whether you are under one of the categories or if you fall under one of the residual categories.

There were lot of discussions, in 2009 and two more categories were added – one is preservation of monuments of historic interest and other the environment. The issue still remained that organisations who fall under the sixth category i.e. involved in general public utility cannot indulge in business activities.

Many Gandhian organisations started saying that Gandhi said to sell Khaadi, so how can you say don't do any business activity. It was then decided that they could do business up to 10 lacs. Later many other organisations also started protesting, so presently the limit is at 25 lacs.

Minimum amount to be applied: 85 per cent of the income has to be applied for charitable purpose. What happens if you are not able to apply 85 per cent? The law says that if you are not able to apply 85 per cent, you can set aside the amount you have not spent and apply it within the next 5 years. If you are not able that fund within the next 5 years, then the 6^{th} year, it will become taxable. 15 per cent of the amount can be accumulated indefinitely, as per Section 11. 1A.

Treatment when income is derived and not received: If you receive the money suppose in March, then you can deem to have been received in the next year and spend it. Accumulated amount has to be spent as per Section 11.5, as has been discussed.

Exemption will be withdrawn if the amount is used for purposes other than which it is accumulated for. Exemption will also be withdrawn if the investment does not remain in the mode of 11.5. So if you use any other mode, then too you will lose the exemption.

Inter-charity donation out of accumulated funds is not permissible. You cannot transfer it to another NGO after accumulating. You have to spend it on your organisation.

In Section 13, we are talking about interested parties:

- If the income is not applied for the benefit of public, 1a
- If income is applied for the benefit of any religious community or caste.
- If applied for the benefit of the persons mentioned in Section 13.3 i.e. Board members and relatives, so on
- And if the funds are invested in modes other than specified in Section 11.5

In Section 13.3, who are the interested persons?

- Author or founder of the organisation.
- Person who has made substantial contribution to the trust.

If someone has made a substantial contribution and becomes a beneficiary, this is not allowed. One cannot be the donor as well as the beneficiary at the same time.

- Any trustee or manager and the relative of such authorised person, founder, member, trustee or manager.
- Any concern which persons mentioned have substantial interests

These are the interested persons mentioned in Section 13.

In business activity for charitable purposes we have already covered the following:

- Relief to the poor;
- Medical relief;
- Education;
- Preservation of environment including water shed projects, wildlife protection;
- Preservation of monuments or places; preservation of places of artistical or historical interest;

- And advancement of the objective of general public utility.

Though the organization is not allowed to do business, it is actually only permitted to conduct incidental business. The business undertaken by the organization must be incidental to the organization's objective.

Conditions to claim Exemption from taxes are as follows:

- Business should be incidental to the attainment of the objective of the organization.
- Separate books of accounts must be maintained, Section 11.4.

For 80G, the organization has to apply in the form 10G. The required documents for application are as follows:

- Copy of the Income Tax Registration Certificate;
- Activities since Inception or last three years, whichever is less.
- Copies of the accounts since inception or last three years.

It should not have any income which is not exempt, for eg. Business income. It should be covered under 12a, which is the most important aspect. Donation given under 80G should not be used for such business. The bylaws should not contain any clause other than which is charitable. The organization should not be working for the benefit of any particular religious community or caste. If that is the case, then the 80G is not normally given, although in Delhi certain Gurudwaras and Churches have 80G exemptions, as a special status. For eg, Cathedral Church of Redemption

Audience: Is it because of archaeological and artistic reasons that it has been provided with the exemption, since it falls in that category?

Speaker: Yes. That is the reason why they get it. Maintains regular books of accounts mentioning expenditure and it should be properly registered in India. If donation of more than 10,000 is made in cash then 80G will not be available. If an organization was holding a valid registration of 80G as on 01/10/2009 then the registration is permanent. Earlier, registrations would have to be renewed every three or five years, now it is one time registration process. So if your organization had a valid registration on 1st October 2009, then it is permanent. And if you were to apply now, then it is one time registration