

AuditAble

11. NPO Taxation under the proposed Tax Code - 3
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4. Payments to Interested Persons

The existing definition of interested persons given in section 13(3) of the 1961 Act, has been retained¹ without any change.

Payment of reasonable salary etc. to interested person working for the organisation will continue to be allowed².

5. Associated Concerns

The Code has introduced the concept of associated concerns³ in the context of NPOs. This has been done to enable NPOs to

invest in the share market etc. while preventing them from diverting welfare funds to associated concerns. Associated concerns have been defined in section 96(c)⁴ read with section 113.

Register of Associated Concerns

While this will allow NPOs more freedom in managing their Corpus or Endowment Funds, it also has an unexpected side-effect. NPOs, which invest their funds, will now be required to maintain and update record/listing of all associated concerns. Without such a record, it will not be feasible for the Governing Board or the Auditors to ensure compliance with this provision.

6. Investing in the Share Market

An important departure is allowing NPOs to invest directly in the share market. This has been done by introducing a list of prohibited investments, in the place of prescribed investments. An NPO can invest its funds in any mode, except those prohibited under section 91⁵. The restrictions are mainly on investing in an associated concern, as discussed above.

7. Donor Incentives

Once the new code comes into force, 100% deductibility for donations to projects approved under section 35AC will end.

However, all non-religious NPOs (approved under section 95⁶ [sic]) will be eligible to offer 50% tax deductibility⁷ to donors. Such donations continue to be limited⁸ to 10% of the gross total income of the donor. This incentive will not be available to religious NPOs.

An NPO engaged in scientific or statistical research may



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also offer 125% tax deductibility (as at present) after necessary approvals⁹.

Tax on Anonymous Donations

In 2006, the Government had imposed a tax of 30% on anonymous donations, to be paid by the recipient NPO. The code makes no reference to this. Apparently, the tax will no longer be applicable.

9. Conversion to for-profit

If an NPO converts to a for-profit organisation either deliberately¹⁰, or due to continuing non-compliance with the NPO conditions¹¹, it will be required to pay tax on its net worth. This tax will be calculated @ 30%.

What is continuing non-compliance? This happens when:

- i. An organisation does not qualify as NPO in a particular financial year.
- ii. It has also not qualified as an NPO in two out of four preceding financial years.

In such a case, the NPO will be treated as having converted

into a for-profit. Accordingly, it will be required to pay tax @ 30% on its entire net worth.

10. Religious Organisations

Religious organisations have been divided into three categories: (i) Those which are set up by the Government to oversee religious places; (ii) Those which are registered under another Government regulation for religious endowments; and (iii) Rest of the religious organisations.

Quasi-Government or Regulated

The first two are completely exempt from tax under section 10, read with schedule VII, entries 37 and 38.

Of these, entry 37 is equivalent to section 10(23BBA) of the present Act. For all practical purposes, these are quasi-Government bodies.

Entry 38 appears to be a new introduction. This will provide unrestricted relief from taxation to organisations already regulated under various state laws. State Acts have been passed for various Hindu endowments in Andhra Pradesh, Karnataka, Kerala, Tamilnadu, Orissa etc. Similarly, an All India Act exists for Muslim Wakfs. All organisations registered under these laws would be exempt under section 10.

Unregulated Religious Organisations

The third category of religious organisations covers residuary religious organisations such as mosques, churches, temples, gurudwaras, agiaries, synagogues scattered across the country. Other religious institutions such as maths, dargahs and seminaries would also be covered under this category. Organisations belonging to all religious sects would be included here, including the New Age organisations. Organisations with mixed objects (partly religious and partly charitable) would also be exempt under this category.

This exemption is on the same footing as for secular NPOs, with the important exception that no deduction is available under section 72 for donors of religious NPOs.



Rough Ride Ahead?

The Code appears to be broadly in line with the thinking of the Revenue Department about exemption to NPOs. It is unlikely that the Government will make significant changes in the Code. NPOs and their tax advisers should, therefore, belt up for a bumper ride in the near future.

Bibliography:

Oxford. (2007). Shorter Oxford English Dictionary. (S. Angus, Ed.) New York: Oxford University Press.

¹ Sec. 96(f): "interested person" in relation to a non-profit organisation means,-

- (i) the founder of the organisation or the author of the trust;
- (ii) any person whose total contribution to the organisation up to the end of the relevant financial year exceeds fifty thousand rupees;
- (iii) a member of the Hindu undivided family if the author or founder or person is the family;
- (iv) any manager, by whatever name called, of the organisation or trustee of the trust;
- (v) any relative of the author, founder, member, trustee or manager;
- (vi) any concern in which any of the persons referred to in clauses (i) to (v) has a substantial interest;

² Sec. 92: The funds or the assets of the non-profit organisation shall be deemed to have been used or applied for the benefit of an interested person, if -

- (a) the funds or the assets of the non-profit organisation are, or continue to be, lent to any interested person, for any period during the financial year without either adequate security or adequate interest or both; or
- (b) the land, building or other asset of the non-profit organisation is, or continues to be, made available for the use of any interested person, for any period during the financial year without charging adequate rent or other compensation; or
- (c) any amount is paid by way of salary, allowance or otherwise during the financial year to any interested person, out of the resources of the non-profit organisation for services rendered by that person to such organisation and the amount so paid is in excess of what may be reasonably paid for such services; or
- (d) the services of the non-profit organisation are made available to any interested person, during the financial year without adequate remuneration or other compensation; or
- (e) any share, security or other property is purchased by or on behalf of the non-profit organisation from any interested person, during the financial year for consideration which is more than adequate; or
- (f) any share, security or other property is sold by or on behalf of the non-profit organisation to any interested person, during the financial year for consideration which is less than adequate; or
- (g) any funds or property of the non-profit organisation, is diverted during the financial year in favour of any interested person where the income or the value of property or, as the case may be, the aggregate of the income and the value of the property exceeds one thousand rupees; or
- (h) any funds of the non-profit organisation are, or continue to remain, invested for any period during the financial year, in any concern in which any interested person has a substantial interest and such investment exceeds five per cent. of the capital of that concern provided that the investment is in one of the forms specified in section; or
- (i) any income in the nature referred to in section 9 is included in the total income of the organisation.

³ Sec. 113 [modified per sec. 96(c)]: "associated concerns" means two concerns which are associated with each other at any time during the financial year, by virtue of -

- (a) one concern holding, directly or indirectly, shares carrying ten per cent., or more, of the voting power in the other concern;
- (b) any person or concern holding, directly or indirectly, shares carrying

- ten per cent., or more, of the voting power in each of such concerns;
- (c) a loan advanced by one concern to the other concern and the loan constitutes twenty-six per cent, or more, of the book value of the total assets of the other concern;
 - (d) one concern guarant[ee]ing ten per cent, or more, of the total borrowings of the other concern;
 - (e) more than one-third of the board of directors, or members, of the governing board, or one or more executive directors, or executive members, of the governing board of one concern, being appointed by the other concern;
 - (f) more than one-third of the directors, or members, of the governing board, or one or more of the executive directors, or executive members, of the governing board, of each of the two concerns, being appointed by the same person or persons;
 - (g) the manufacture, or processing, of any goods or articles of, or carrying on the business by, one concern being wholly dependent on the use of know-how, patents, copyrights, trade-marks, brands, licences, franchises, or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other concern is the owner or in respect of which the other concern has exclusive rights;
 - (h) two-third, or more, of the raw materials and consumables required for the manufacture, or processing, of goods or articles carried out by one concern, being supplied by the other concern, or by persons specified by the other concern, and the prices and other conditions relating to the supply are influenced by such other concern;
 - (i) the goods or articles manufactured, or processed, by one concern, being sold to the other concern or to persons specified by the other concern, and the prices and other conditions relating thereto are influenced by such other concern;
 - (j) one concern being controlled by an individual, and the other concern being also controlled by such individual or his relative, or jointly by such individual and his relative;
 - (k) one concern being controlled by a Hindu undivided family, and the other concern being also controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative;
 - (l) one concern holding ten per cent., or more, interest in another concern being an unincorporated body; or
 - (m) there existing between the two concerns, any relationship of mutual interest, as may be prescribed;

⁴ Sec. 96(c): "associated concern" shall have the meaning assigned to 'associated enterprises' in section 113, with the modification that for the word 'enterprise' with all its grammatical variation, the word 'concern' with its corresponding grammatical variation shall be substituted;

⁵ Sec. 91: (1) The forms and modes of investment referred to in sub-clause (xi) of clause (d) of section 96 shall be the following, namely:-

- (a) investment in the capital or equity, as the case may be, of an associated concern;
- (b) investment in any bond, debenture or any other debt instrument issued by an associated concern;
- (c) deposit with an associated concern; and
- (d) any other form or modes of investment as may be prescribed.

⁶ Possibly refers to sec. 93, as sec. 95 does not deal with approvals.

⁷ Sch. 16, Part C, entry 6

⁸ Sec. 72(2)

⁹ Schedule 16, part A

¹⁰ Change of form of organization or failure to transfer all assets to another NPO on dissolution

¹¹ Sec. 96(d)

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