

# 7. Income Tax<sup>1</sup>

Some people believe that NGOs are automatically exempt from income-tax. This is not true. You need to apply for income tax exemption. After that you need to follow certain conditions in order to remain exempt. Additionally, there are other requirements which affect an NGO's working.

Broadly there are three types of registration. Basic registration means that the NGO will not have to pay income tax<sup>2</sup> on its surplus<sup>3</sup>. This is the most important registration and every NGO should have it.

Next comes registration for TDS<sup>4</sup>. NGOs have to deduct income tax when they make payments to some people. After deducting tax, this is deposited with the Government.

Third is the approval for donors. These approvals mean that your donors will have to pay less income tax whenever they donate money to you.

## a) Basic registration and exemption

For NGOs involved in development<sup>5</sup> work, basic income tax exemption can be of two types. One is under section 10 and the other is under section 11.

### (1) Exemption under section 10

Section 10 has many sub-sections. Each sub-section has several clauses. For NGOs, the relevant clause is 10(23C)(v)<sup>6</sup>. This exemption is not available very easily. You need to apply to the Director General of Income Tax (Exemptions) at Kolkata (कोलकता) through your local Income Tax Commissioner. The application is made in form 56.

After an inquiry, your application may be approved. Then a notification will be published. The exemption is granted for a maximum period of three years. After that, you need to apply for a renewal.

### (2) Exemption under section 11

It is easier to obtain exemption under section 11<sup>7</sup>. For this, you have to apply for registration to your local Income Tax Commissioner. For this you use form 10A. Ideally you should make this application within one year of formation<sup>8</sup>.

<sup>1</sup> Only basic information is provided here. Please consult your advisers or a lawyer before taking important decisions.

<sup>2</sup> Subject to certain conditions.

<sup>3</sup> When income (including grants) is more than the expenditure, you get a surplus.

<sup>4</sup> Tax Deduction at Source

<sup>5</sup> Income Tax Act uses the word 'charitable'

<sup>6</sup> Pronounced as 'section ten [pause] twenty three see'. If you want to be perfect, add 'clause five' after you say this. If the NGO is of national or regional importance, then you can apply under clause (iv)

<sup>7</sup> This is sometimes also called '12A registration'

<sup>8</sup> Creation of Society or Trust

If for some reason you have not been able to do this, then the Commissioner may overlook this. For this you should submit a separate application<sup>1</sup> asking that the delay may be forgiven.

Under the revised procedure, the Commissioner has to decide on your application within six months. For this, you may need to provide more information or attend a personal hearing. The Commissioner also has the power to refuse registration<sup>2</sup>.

## b) Permanent Account Number

In recent years, the Income Tax Department has been doing some serious revamping of the Permanent Account Number system. As a result, now almost everyone has to apply for a Permanent Account Number (PAN). Quoting this number will gradually become essential for almost all important transactions. However, you will still be able to purchase milk at the nearby dairy without providing your PAN!

**Your NGO also needs to apply for a PAN.** Form number 49A for this will be available with your auditors or the local Income Tax office – just ask for PAN application form. Fill up the form in duplicate and file it with the Income Tax office. One copy will be returned to you. In some areas, separate offices have been designated for this. You will get an acknowledgement, which you should preserve carefully.

In due course of time, you will get a laminated card showing your PAN. PAN cards for individuals also carry their photographs. Note this number down in your diary so that you can provide it when asked.

In some cases, PAN takes a long time to arrive. Till the time you get the PAN, you can quote your General Index Register Number (GIR number). This number is given on your assessment order.

Finally, a person who has neither a PAN nor a GIR number, can make a declaration to this effect in Form 60<sup>3</sup> and conclude their transaction.

## c) Special conditions

Under the Income Tax, there are some special conditions. If you do not follow these, you may have to pay income tax or penalty. In some case, imprisonment is also possible.

### (1) Large loans or expenses in cash

**Under Income Tax Act<sup>4</sup>, loans of Rs.20,000 or more have to be taken or repaid by crossed account payee cheque or draft.** What does the limit of Rs.20,000 mean? Obviously, any single loan of Rs.20,000 or more is covered. But the ban also applies when the amount due to one person adds up to Rs.20,000 or more. This legal position will be clearer from the examples below:

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<sup>1</sup> Format in section on forms

<sup>2</sup> Section 12AA

<sup>3</sup> Form 61 for people having agricultural income

<sup>4</sup> Section 269SS

Account of Sri Ajay Choudhury						
Date	Particulars	CBF	Debit	Credit	Dr/Cr	Balance
4.4.98	Loan taken in cash			10,000	Cr.	10,000
15.5.98	Loan taken in cash			7,000	Cr.	17,000
29.6.98	Cash repaid		8,000		Cr.	9,000
14.7.98	Loan taken			10,000	Cr.	19,000

No violation of  
Income Tax Act

Account of Sri Venkat						
Date	Particulars	CBF	Debit	Credit	Dr/Cr	Balance
5.4.98	Loan taken in cash			10,000	Cr.	10,000
10.5.98	Loan taken in cash			10,000	Cr.	20,000
25.6.98	Cash repaid		8,000		Cr.	12,000

Violation of  
Income Tax Act  
on 10<sup>th</sup> May '98

Account of Mrs. Kalyani Devi						
Date	Particulars	CBF	Debit	Credit	Dr/Cr	Balance
4.4.98	Loan taken in cash			20,000	Cr.	20,000

Act  
violated

Under the Income Tax Act, you should also not make any payment (for expenses or assets<sup>1</sup>) above Rs.20,000 in cash<sup>2</sup>. If you do, then 20% of the amount will be added back to your income. There are some exceptions to this<sup>3</sup>. These include payments to farmers for farm products and to cottage industries. If you make a payment to a person who lives in a place without a bank, then you can make it in cash.

Sometimes, business persons are advised to split up large payments so that each payment is below Rs.20,000. This is not a good idea for NGOs, who are more responsible and accountable socially.

<sup>1</sup> Remember that NGOs get 100% deduction for assets.

<sup>2</sup> Section 40A(3)

<sup>3</sup> Rule 6DD

## (2) Investments and bank accounts

You are expected to keep the funds of the NGO in bank accounts or in specified investments<sup>1</sup>. These are listed<sup>2</sup> below:

- Government Savings Certificates (including Indira Vikas Patra and Kisan Vikas Patra)
- Post Office Savings Bank Accounts
- Accounts (whether fixed or savings) with any Scheduled<sup>3</sup> Bank or any co-operative bank
- Central or State Government Securities
- Units of Unit Trust of India
- Shares or Deposit with any *Public Sector* company
- Land, buildings or other immovable property
- Deposits or Bonds of approved<sup>4</sup> Industrial Financing Corporations
- Deposits or bonds of approved Housing Loan companies
- Deposits etc. with IDBI
- other prescribed investments (units of Mutual Fund; deposit to Public Account of India)

However, local laws (such as Bombay Public Trust Act) may specify other investments. You will need to work out a common list of permitted investments for your state before investing. Also this list may change from time to time. Ask your auditors before investing.

## (3) Separate account books for Income Generation

Do you have any income generating activities? These may be of two types: one, where you help the villagers take up some economic activity; and two, where you yourself run these. In the first case, the income will not come to you. No entries will be made in your account book.

In the second case, you will receive some income. This may be from sale of books, honey, handloom products, medicines or from running training programs. The activity must be regular and structured: selling old books once in a while is not Income Generation activity for Income Tax purpose. But if you print books and sell these regularly for a price, it becomes a business activity.



Such activity is allowed under Income Tax act. If the profits from this are ploughed into 'charitable' activities then there is no tax on this.

However, you need to keep a separate cash book and ledger for these activities (as given in second case). If you don't do this, you may lose your exemption under section 11.

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<sup>1</sup> Section 11(5)

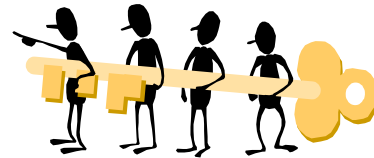
<sup>2</sup> NGOs exempt under section 10(23C) are allowed some relaxation from these provisions.

<sup>3</sup> Almost all large banks are scheduled banks. In case of doubt, ask the concerned bank.

<sup>4</sup> For section 36(I)(viii)

**(4) Transactions with key persons**

Income Tax people keep a close eye on payments to people who may be in a position to control the NGO. We need to understand two things: 1. Who may be a key person. 2. What transactions are covered.

**(a) Who is a key person**

According to the Act, following persons<sup>1</sup> are treated as key persons:

1. **Author of the Trust:** the person who set up the Trust initially; also known as settler
2. **Founder(s) of the society:** The persons who signed the Memorandum of the Society are normally known as founders.
3. **Key Donors:** Any person whose cumulative<sup>2</sup> contribution to the trust or society exceeds Rs.50,000.
4. **Trustees, Managers:** This includes Chief Functionary, Executive Director, Director, Secretary, office bearers.
5. **Close relatives:** Any relative of any of the above four categories. 'Relative' means<sup>3</sup>:
  - ❑ Spouse (husband / wife)
  - ❑ Brother or sister, their children (nephew / niece)
  - ❑ Brother-in-law or sister-in-law, their children
  - ❑ Any lineal ascendant (parents, grand-parents...) or descendants (children, grand-children...) – this includes step-children and parents-in-law.
6. **Associated Concerns:** Any company, business, or firm in which any of the above five categories have a 'substantial interest'. Substantial interest means that they should be holding 20% shares or they should be entitled to 20% profits of the business.

**(b) What type of payments are covered**

These payments are listed in section 13(2). The section does not prohibit payments as such – it comes into play when these payments may be unreasonably high:

<i>Type of payment</i>	<i>Yardstick</i>
Money or property of NGO is lent to key person	<ul style="list-style-type: none"> <li>❑ Whether sufficient security has been taken</li> <li>❑ Whether enough interest is being charged</li> </ul>
Salary or allowances paid to key person by NGO	<ul style="list-style-type: none"> <li>❑ Whether these are reasonable<sup>1</sup> or high</li> </ul>

<sup>1</sup> Section 13(3)

<sup>2</sup> From the beginning till end of current financial year

<sup>3</sup> For exact definition, see explanation 1 to section 13

<i>Type of payment</i>	<i>Yardstick</i>
Services of NGO provided to key person	<input type="checkbox"/> Whether enough remuneration was charged
Purchase of property (or shares / investments) from key person	<input type="checkbox"/> Whether amount paid was too high
Sale of property (or shares / investments) to key person	<input type="checkbox"/> Whether amount charged was too low
Income or property of NGO diverted to key person	<input type="checkbox"/> Does not apply where the total value of property / income is One thousand rupees or less

As you can see from the above, the restrictions under these clauses are very complex and open to dispute. **It would be best to avoid such payments, except where clearly necessary or justifiable (such as salary).**

### (c) **Use of assets**

Similar **restrictions apply on use of NGO's assets by key persons**. Following cases are mentioned in section 13(2):

<i>Nature of use</i>	<i>Yardstick</i>
Land, building or other property of NGO used by key person	Whether enough rent or compensation was charged
Funds of the NGO are invested in key person's concern (business or company)	Upto 5% of capital of key person's concern can be invested <sup>2</sup>

### d) **Filing of Income Tax Return**

**All NGOs have to file Income Tax return annually.** This return should be filed in form IIIA. Form IIIA is available in the Income Tax Office or with stationery shops which sell government forms. Your CAs will also have this. The form is also include in any compilation of Income Tax Rules .

Remember, you can start filing your return even if you have just applied for registration under Income Tax Act. Do not wait for grant of registration – just say ‘applied for’ at the relevant place in form IIIA.

The following information is given for general awareness. It is strongly recommended that you consult your CAs or an Income Tax practitioner for filing the return.

#### (1) **Last date and audit**

NGOs filing Income Tax return are divided into two categories: big and small. Who is big and who is small? This depends on their Gross Total Income. If this exceeds

<sup>1</sup> ‘Reasonable’ is not defined. Salary in an alternative job can be a bench-mark.

<sup>2</sup> But even this may attract disqualification under section 13(1)(d)

Rs.50,000, then the NGO is big – otherwise it is small. This income should be calculated under the Income Tax Act, without deducting exemptions under section 11 or 12! Sounds too complicated? For practical purposes, most NGOs getting grants from Government or any Agency are likely to fall under income tax definition of big.

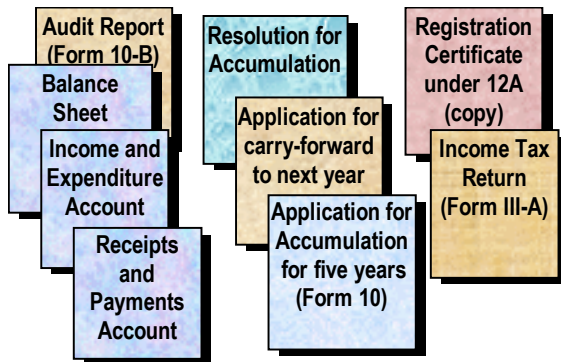
**(a) Big NGOs**

Last date for filing return in form IIIA is 31<sup>st</sup> October. This means that for financial year 1-Apr-04 to 31-Mar-05, the last date will be 31-Oct-05. Audit report in form 10B should be attached to the return.

**(b) Small NGOs**

Last date for filing return in form IIIA is 31<sup>st</sup> July. Audit report in form 10B is not required.

The complete return should be filed with the Income Tax Department. They will give you a stamped acknowledgement for this.



**A complete set of Income Tax Return**

Before filing the return, check that you have attached the documents shown in the picture on the left. If you have left out any document, make sure that it was not required. It is possible, that the complete Income Tax return may look like the picture on the right.



**e) Approval for donations**

If you want to raise money from public or friends, people may ask you whether they will get a tax-deduction. If you are not approved under section 80-G or section 35AC, your answer should be ‘no’. Remember, registration under section 12 makes you (NGO) exempt from tax – it does not give any advantage to the donors.

If you want to offer tax advantage to your donors, you should get approval under section 80G or under 35AC

**(1) 50% under section 80G**

For this approval you have to apply in form 10G to the local<sup>1</sup> Income Tax Office. Normally this approval is granted for 2-3 years at a time but can be renewed. This is a general approval and you can raise money for any charitable purpose.

The donors get a deduction of 50% from their *taxable income*. Note this carefully: they get a deduction of 50% from their income, not from their income *tax*. Most people find this confusing so let’s look at an example:

<sup>1</sup> Confirm jurisdiction with your CAs or tax advisers.

Ms. Anju gives a donation of Rs.1,000 to Lok Jagran Manch under section 80G. Anju's total taxable income for 98-99<sup>1</sup> is Rs.100,000. Tax on this comes to Rs.9,000. Because she has given this donation, her income will be reduced to Rs.99,500. The tax on this will be Rs.8,900. So her tax saving is only Rs.100.

She will be able to claim this deduction only if you give her a receipt. The receipt should show the 80-G approval number also. Try to get the donation by cheque – this will help her prove the donation to her Income Tax officer.

**(2) 100% under section 35AC**

If you get approval under section 35AC, Anju can save a little more money. The same donation of Rs.1,000 under 35AC will allow her to claim a deduction of Rs.1,000 from her income. Her net income will be Rs.99,000. Tax on this will be Rs.8,800. So she will save Rs.200.

Approval under 35AC is centralised at Delhi<sup>2</sup>. You have to fill up a separate application form (see form on page 95). The approval is given for a specific project and carries a limit on how much funds you can raise. Approval is now available for corpus based projects as well. Remember that the Ministry will not give you any funds – only approval to raise tax-deductible donations.

The approval is usually for 2-3 years but can be extended. You have to give each donor a certificate in form 58-A – without this form, the donor can not claim deduction. You also have to file periodic progress reports with the National Committee.

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<sup>1</sup> Financial year

<sup>2</sup> Apply to 'The Secretary, National Committee for Promotion of Social and Economic Welfare, Department of Revenue, Ministry of Finance, Room No.149, North Block, New Delhi-110 001'