

AccountAble™

117. Consultancy Fees and NGOs – 1

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Many people think that NGOs run on donations and grants. This is true for most NGOs. But not for all. For example, hospitals and schools¹ run on fees. Similarly there are technically competent NGOs, which provide consultancy services. These services may include evaluation of projects, project design, training services, layout design, artwork, publications, etc.

This issue of AccountAble deals with legal and accounting aspects of consultancy services provided by NGOs.

1. Legal Aspects

Let us first look at the legal issues related to this.

a. Enabling Clause

Is the NGO empowered to undertake consultancy services? This can be seen from the Memorandum of Association or Trust Deed. In most cases, you may not find consultancy as a

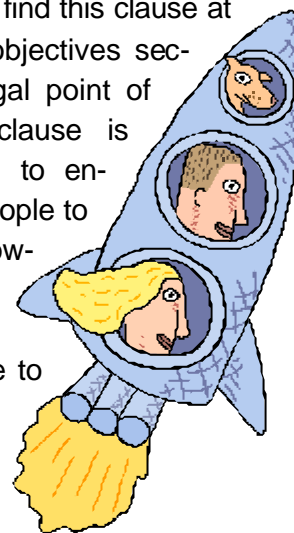
¹ Strictly speaking, hospitals and schools that run on fees are not NGOs, as these mostly do not have a social action agenda. These fall into the category of public-utility organisations. On the other hand, NGOs fall into the category of public-benefit organisations.

main or direct objective in the Memorandum. This means that the organisation was not set up for providing consultancy services etc.

What does this mean? Can the NGO provide consulting services or not? Well, in most cases, there is a catch-all clause which goes somewhat like this:

“to do such acts and things as may be necessary and / or incidental to the aforesaid aims and objects and as may be agreed to be taken up by the Governing Board from time to time”.

You will normally find this clause at the end of the objectives section. From a legal point of view, such a clause is powerful enough to enable you to fly people to the moon! However, you must be able to show that flying people to the moon is incidental or ancillary to your main objectives.



The lesson is that in almost all the cases, you can provide consultancy services without any fear. However, to be on the safer side, just take a quick look at your memorandum before doing so.

There is a catch² to using the catch-all clause to provide consultancy services. Ideally, therefore, it would be best if you include the consultancy clause in your main objectives. This clause should be inserted in addition to the catch-all clause. The clause could look like the following:

“To accept consultancy assignments, provide advisory services, and undertake other income-oriented activities to generate income for the society / Trust”.

b. Income Tax

If an NGO receives fees against consultancy or some similar service, does it have to pay income tax? Or, will it lose its tax exemption? No. It does not have to pay any income tax. Neither will it lose its tax-exempt status. NGOs are not barred from generating an income or making a profit. However, profit-making should not be the primary objective of an NGO.

In practice, this means that the profits should be ploughed into achieving some socially useful or charitable objective. Further, profits should not be distributed as dividend etc. among the members.

TDS

The consultancy income of an NGO will not be taxed if the NGO is registered under section 12A. However, this comes later. At the time of making the payment of fees, the client agency has to deduct tax at source.

² See the discussion under the heading 'FCRA' for more on this.

This tax is deducted under section 194J of the Income Tax Act, 1961. Presently, the rate of deduction is 5%. However, surcharge (SC) and education cess (EC) vary:

Total Amount	Tax	SC	EC	Total
Upto 10,00,000	5%	0	0.1	5.1%
More than 10,00,000	5%	0.5	0.11	5.61%
Non-profit Company	5%	0.5	0.11	5.61%

What happens to the amount deducted by the client agency? The NGO should file a claim for refund when it files its annual income tax return.



Normally, the refund will be processed within 6-12 months. It will be sent to the NGO by cheque.

cheque.

Depositing the Refund Cheque

If the consultancy income is received from the Indian source, the TDS should be deposited in Indian bank account. What if the consultancy was received from a foreign source?

In our view, this depends on where you deposited the original cheque for the consultancy fees. If you had deposited it in FCRA account, then deposit the refund cheque also in the same bank account.

A doubt arises here. What if part of the refund relates to FCRA fees and another part relates to Indian funds? Remember that you will get only one

refund cheque from the Income Tax Department. In our view, the best option will be to deposit the cheque in the Indian account. After this, make out a cheque (favouring your own NGO) for the FCRA portion. Deposit this cheque in the FCRA bank account.

c. Service Tax

Service tax was introduced by the Government in 1994. Over the last decade, the Government has gradually brought more and more services under its net. Also the rate has been gradually increased from 5% in 1994 to 12.24% in 2006. It is now a very big source of revenue for the Government. In 2005-06, the Government collected Rs.2.31 *kharabs*³ from service tax.

Service Tax is applicable throughout India except Jammu and Kashmir. There is also a threshold limit: if the total value of services billed by you in a financial year does not exceed Rs. 4,00,000 per year, then you don't have to pay service taxⁱ. However, registration under service tax is required the moment you cross the limit of Rs.3 lakhs in a financial yearⁱⁱ.

Clubs and Associations

Service tax is also applicable to services provided by clubs or associations to its membersⁱⁱⁱ against a subscription or fees. This covers organizations such as Gymkhana Club, Golf



³ 23,115.46 crores. 1 *kharab* (orb) is equal to 10,000 crores.

Club or Resident Welfare Associations. These organizations provide services to their members only.

However, NGOs having charitable, religious or political objectives, and providing public services are exempt from this^{iv}.

Management Consultancy

Service tax is also applicable to management consultancy services provided by commercial or professional organisations. What is management consultancy?

The term management consultant has been defined in section 65(65). Service tax is levied on such services through section 65(105)(r). This section is restricted to services provided

At Your Service

Our legal system is full of traps. If you try to avoid one, you can fall in another.

For example, in order to avoid high amount of TDS, a senior employee may be shown as a consultant or an adviser. TDS is then deducted at around 5% only under section 194J. This makes all the more sense now, as salaried employees have lost almost all their tax benefits.

However, if the employee is drawing more than Rs. 4 lakhs per year, then a problem may arise. He or she may have to pay service tax on the 'fees' received from the NGO.

Currently, at 12.24%, that works out to an additional 48,960 or more, each year!

Moral of the story? Sometimes, it's cheaper to serve than to advise!

to a client, in connection with management of any organization. Thus service tax is chargeable on any consultancy services connected with management of an organization or on systems consultancy.

Management Consultancy by NGOs

But what happens if these services are provided by NGOs? Do they also have to pay tax?

Unfortunately, there is no exemption for consulting services provided by an NGO against fees. This means that if an NGO's income from management consultancy exceeds Rs.4 lakhs in a year, they have to pay service tax. For this purpose, they should include the amount of service tax in the consultancy contract.

Examples where consultancy NGOs could end up paying service tax include:

- A field-study conducted on migration of Ridley's turtles in coastal Orissa or on arsenic poisoning of water in West Bengal;
- An evaluation of an NGO's program on behalf of a donor agency;
- A capacity-building program for NGOs, sponsored by a donor agency;
- Program management services, where the entire program-management is outsourced to an NGO.

In the next issue of AccountAble, we will discuss FCRA and accounting as-

pects of consultancy income.

...Continued in AccountAble 118

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ⁱ Notification number 6/2005-ST, dated 1-3-05, effective 1-Apr-05

ⁱⁱ Notification number 26/2005-ST, dated 7-6-2005, effective 16-Jun-2005

ⁱⁱⁱ Section 65(105)(zzze) of Finance Act, 1994.

^{iv} Section 65(25A) of Finance Act, 1994.