12. Taxing NGO Programs Outside India - June '12

auditable

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Income Tax Act allows NGOs to claim deduction for income applied to charitable or religious purposes in India.[1] Additional conditions must be met if the income is applied to such purposes outside India.[2] We discuss the law and court cases on this issue in the following paragraphs.

Applied in India

Sec. 11(1) says that if the income is applied to charitable or religious purposes in India, then it will not be taxed. This sounds simple enough at first glance. However, several questions arise:

- What is the meaning of 'charitable or religious purpose in India'? Should the purpose be located within India?
- Should the beneficiaries remain in India while they consume the benefits provided by a Trust?
- Should the application occur within India?
- What does application itself mean?[3] Does it mean that payment should occur within India, or does it mean that the services / products must be used within India?

This section has been on the books for a very long time, since 1922.[4] However, there are only three cases which throw light on this. The first is a Chennai ITAT order dating back to 1989. The second was decided by the Supreme Court in 2000. The third has been pronounced by the Delhi High Court in May'12. Let us look at each of these briefly:

1989: Bharata Kalanjali[5]

Bharata Kalanjali was set up as a public charitable trust to propagate Indian classical and folk arts. In 1982, the Trust was requested by the Government of India to conduct a dance tour in Nigeria. The trust spent Rs.1.55 lakh on the fare of the troupe - this money was paid to Travel Corporation of India. During a review of the assessment[6], the CIT disallowed the expenditure. Reason offered was that performing outside India was not covered by the objects of the Trust. Further, this money could not be treated as 'applied in India' as the dance performance took place outside India. According to Tax Department, both the purpose and the spending should be in India. The Trust went into appeal. The Chennai Tribunal allowed the appeal. It found that there was no restriction in the Memorandum on doing tours in India alone. Secondly, though the activity (performance in Nigeria) had occurred outside India, the payment had occurred in India. Therefore the expenditure was allowable.

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[1] Sec. 11(1) of the Income Tax Act, 1961

[2] Sec. 11(1)(c)

[3] Commissioner Of Income-Tax, ... vs Trustees of H.E.H. The Nizam's Charitable Trust (1981) [131 ITR 497 AP]

[4] There have been some minor changes in wording - however, the construction of the section has remained essentially unchanged.

[5] Bharata Kalanjali vs. ITO (1989) [34 TTJ (MAD) 338; 30 ITD 161]

[6] AY 1983-84

2000: HEH Nizam's Pilgrimage Trust[7]

In 1950, the Nizam of Hyderabad set up a trust to provide money for himself and other family members for Haj and other pilgrimages. After his death, the money was to be used for various charitable and religious objects at Hedjaz or Iraq. He could not use any of the funds during his lifetime. The money remained unutilised even after his death in 1967, as there were government restrictions on remitting funds abroad. The Trustees then applied to the High Court u/s 34 of the Indian Trusts Act for redefining the trust's objects so that they could spend the money on objects within India. Subsequently[8] the Wealth Tax Officer imposed wealth tax on the Trust's assets. The Officer argued that the charitable and religious purposes of the Trust were not in India. Therefore, the Trust was not entitled to exemption from Wealth Tax.[9] The Trust argued that the property was located in India - it did not matter where the objects were to be fulfilled. After several appeals, the question was referred to Supreme Court.

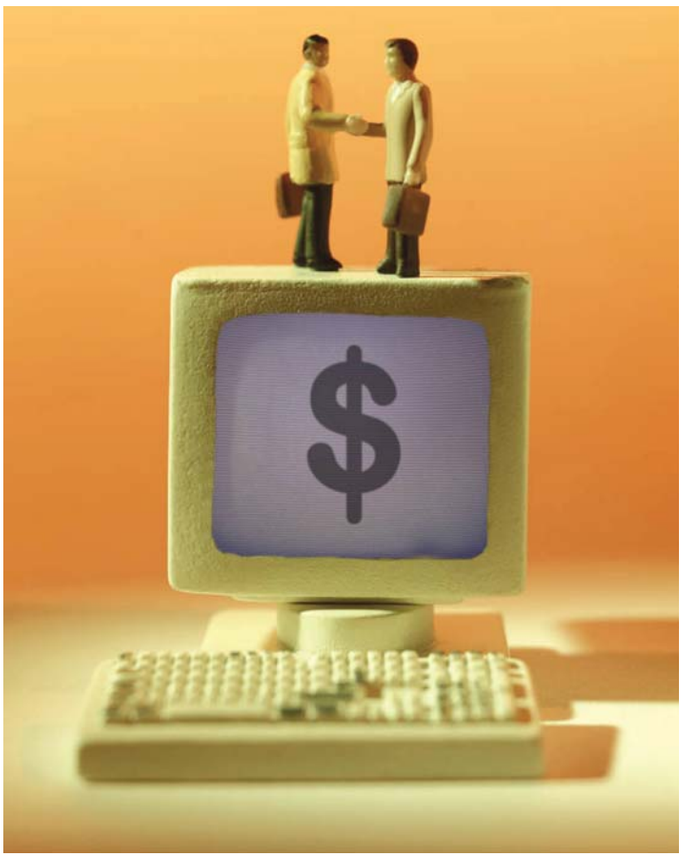
The Supreme Court concluded that the change in objects, allowed by AP high Court was not valid. Indian Trusts Act does not apply to public trusts. Therefore, the objects of the Trust continued to remain outside India.

Further, the Court pointed out that the words 'in India' are used after the phrase 'any public purpose of a charitable or religious nature'. These are not used after the phrase 'any property'.[10] Therefore, the location of Trust property is entirely irrelevant. It is the location of the charitable and religious purposes that is important. These must be within India. Therefore, the question was decided against the Trust.

2010: ICAI[11]

ICAI has been established by an Act of Parliament to regulate the profession of Chartered Accountancy in India. It is notified as exempt from tax under section 10(23)(c)(iv) of Income Tax Act. Its officers also undertake foreign travel as part of their work. The ICAI also pays membership fees of foreign professional bodies. The Income Tax Department disallowed expenditure on foreign travel, foreign membership fees etc. stating that these activities are for international welfare. Therefore permission from CBDT should have been obtained.

The Tribunal found that firstly, CBDT permission is required under sec. 11(1)(c) for NGOs claiming exemption under section 11. It does not apply to NGOs exempted under section 10(23)(c). Secondly, traveling to foreign countries, membership of foreign bodies cannot be considered to be activities for international welfare. These activities are for maintaining and regulating the professional standards within the country. Accordingly, the decision was given in favour of ICAI.



2012: NASSCOM[12]

NASSCOM is a trade body promoting the work on Indian software and IT companies all over the world. It is registered under section 12A. NASSCOM participated in several trade fairs, including one in Hanover, Germany. It claimed Rs.38.29 lakh as expenditure on this account. This was disallowed by the tax authorities as being application of trust income to charitable objects outside India. The Tribunal ruled that the purpose of the trust should be in India. It is not necessary that the application should also be in India. It therefore ruled in favour of NASSCOM. Tax authorities appealed against this in Delhi High Court.

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[7] Trustees of HEH Nizam's Pilgrimage Money Trust, Hyderabad vs. CIT, Andhra Pradesh, [243 ITR 676 (SC); 160 CTR (SC) 242; 111 Taxman 228 (SC)]

[8] AY 1974-75 to 1977-78

[9] This case relates to section 5 of the Wealth Tax Act. However, the principles of law would apply to interpreting section 11 of the Income Tax Act as well, as both provisions have a similar structure.

[10] '5(1) (i) any property held by him under trust or other legal obligation for any public purpose of a charitable or religious nature in India'

[11] Institute of Chartered Accountants of India vs. Director of Income Tax (Exemption) [(2011) 136 TTJ (Del)548: (2011 50 DTR 409]

[12] Director of Income Tax (Exemption) vs. National Association of Software and Services Companies (2012) [indiankanoon.org]

The Court examined this issue at great length. It quoted Kanga and Palkhivala with approval - '…the Revenue confines the right of exemption to only such trusts as are administered for the benefit of the public of India…'. It then concluded that section 11(1)(a) calls for 'the income of the trust [being] applied in India for charitable or religious purposes'. Based on this, the Court ruled against NASSCOM and disallowed the expenditure on trade fairs outside India.

Analysis

In Bharata Kalanjali case, Revenue had argued that both the payment and the purpose must be in India. However, it was held that the location of payment was important - the site of the activity was not. The rationale followed in Nizam's Pilgrimage Trust case is different. Supreme Court took the position that the location of the purpose was more important. This reasoning has been applied in the ICAI and the NASSCOM cases as well. Of the four, the NASSCOM case is a direct authority on the issue, and is more likely to be followed due to its detailed reasoning. Unless it is overturned on appeal by NASSCOM.

Conclusion

The interpretation of 'to the extent such income is applied to charitable or religious purposes in India' remains contentious. It can be interpreted in different ways. Most NGOs tend to ascribe a wide meaning to these words. However, the Income Tax Department is unlikely to adapt a liberal (or charitable!) interpretation. The courts also appear to support the Revenue's approach.

What should NGOs do in practice? It seems that deductibility becomes uncertain if the activity occurs outside India. The question of ultimate benefit trickling down to India is not considered as a mitigating factor. Therefore, tax exempt NGOs should not conduct any programs or activities outside India.

If an NGO spends money outside India on foreign travel etc., then this expenditure would be deductible. However, this travel must be clearly for charitable purposes within India.

Scholarships granted to Indian nationals for studying abroad might not be considered as spent outside India for this purpose.[13] However, if scholarships are granted to non-Indians outside India, then a Trust may not be able to claim this under section 11(1)(a). It would need a CBDT order under section 11(1)(c) to claim deduction for this.[14]

Would expenditure on promoting international peace and harmony be deductible? Apparently yes - so long as the expenditure is incurred within India. If this work involves foreign travel or programs are conducted outside India, then CBDT permission would be needed.

Applied Outside India

The bar on applying charity funds outside India is not an absolute one. Deduction can be allowed, provided you have the necessary permissions. Two conditions must be met:

1. The activity promotes international welfare in which India is interested.[15]
2. The Central Board of Direct Taxes has passed a general or special order in this regard.

Both the conditions must be fulfilled for an NGO to claim deduction. To our knowledge, CBDT has not passed any general order in this matter. Therefore, you need to apply for each case. The application should be addressed to the Secretary of the CBDT at North Block, New Delhi -1. Suggested format is given below:

Dear Sir:
Sub: Order under proviso to sec. 11(1)(C) of the Income Tax Act, 1961
Ref: [Name of Organisation] - Permanent Account Number [_____]

We are a [Society / Trust / Sec. 25 Company] registered under [registering Act] on [date]. The organisation works wholly for charitable purposes and is registered under section 12A of the Income Tax Act, 1961. The organisation has been working towards [purposes] since [year] in the [geographical area].

The organisation [now proposes to spend / has spent] Rs._____ during the previous year relevant to assessment year [year] for [brief description of international program].

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[13] P. 2272, Law of Income Tax - Sampath Iyengar, 11th Edition

[14] M.K. Nambyar SAARC Law Charitable Trust vs Union of India and Ors. [(2004) 190 CTR Del 29, 2004 (75) DRJ] 438

[15] This condition does not apply to trusts created before 1-Apr-1952.

This program has the support of [Ministry / Agency etc.], per letters enclosed. The program is being undertaken in consultation with the Indian Embassy / High Commission in [country] per correspondence enclosed.
[Proposed budget / detail of amounts spent] is enclosed for your perusal as is a narrative describing the program activities. This program is designed to promote international welfare in which India is interested.
It is therefore prayed that Board may pass an order directing that [amounts spent on the above program upto Rs. _____ / amount already spent as above] be not included in the total income of the organisation, as provided in proviso to sec. 11(1)(C) of the Income Tax Act, 1961.
Yours etc.
[Secretary / Trustee / Director]
Place / Date

Off-shore Charities

Taking permission from CBDT on a case-by-case basis is feasible only for occasional programs abroad. What should be done if an Indian NGO wants to promote its program objectives in other countries? The founders should then consider promoting / registering a different organisation in that country. Alternatively, the organisation can be registered in a country such as USA which permits charities to spend funds abroad. Funds for the foreign programs should then be raised internationally and remitted directly to the foreign charity's account. No funds should be remitted to them from the Indian organisation's account.

FCRA Implications

Does FCRA permit Indian NGOs to spend money on programs abroad? There appear to be no restrictions on this under FCRA 2010. Rule 9 of FCRR 2011 permits opening of secondary bank accounts. Such a secondary account can also be opened in a foreign country, after obtaining RBI permission.[16] Therefore, if CBDT permission has been obtained, then there are no adverse legal or financial implications of taking up programs abroad.

Report in Form 10B

The audit report in Form 10B also seeks information on spending abroad. Item 1 asks the auditor to state the amount applied to charitable or religious purposes in India. Therefore, any amounts applied to charitable or religious purposes outside India must be excluded from this figure. If the NGO has obtained CBDT permission for applying amounts outside India to international welfare, then the amount spent must be reported under item 4.

In practice, this aspect is sometimes ignored by audit staff. However, negligence in this matter can be treated as professional misconduct under the following clauses 5,6,7,8 of Part I of Second Schedule to The Chartered Accountants Act, 1949:

Clause (5): fails to disclose a material fact known to him which is not disclosed in a financial statement, but disclosure of which is necessary in making such financial statement where he is concerned with that financial statement in a professional capacity;

Clause (6): fails to report a material misstatement known to him to appear in a financial statement with which he is concerned in a professional capacity

Clause (7): does not exercise due diligence, or is grossly negligent in the conduct of his professional duties;

Clause (8): fails to obtain sufficient information which is necessary for expression of an opinion or its exceptions are sufficiently material to negate the expression of an opinion;

NGO Auditors should therefore ensure that the audit team is aware of the requirements under secs. 11(1)(a) and 11(1)(c). They should also modify the audit tests to check for amounts spent on program activities outside India.

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[16] See Rule 7 of Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) Regulations, 2000, as amended by Notification No.FEMA47/2001-RB (December 5, 2001), and read with A.P. (DIR Series) Circular No.54 (June 29, 2002)

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Printed and published by Ms. Renu Agarwal for AccountAid India, New Delhi. Ph. 26343128, at PRINTWORKS, F-25, Okhla Industrial Area, Phase 1, New Delhi. 110020

Content: Shri Sanjay Agarwal
Editing: Ms. Soumyasree Mullick
Design: Ms. Moushumi De
Images: Microsoft
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