

AuditAble

2. Charitable Purpose - I
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Under the Income Tax Act, 1961, charitable and religious organisations are exempt from income tax. The exemption from Income Tax is provided in section 10¹ and section 11. However, to avail this, the organisation's income should be mainly applied to charitable or religious purposes.

This leads us to two important questions:

1. What is charitable purpose?
2. What is religious purpose?

In this issue of AuditAble, we consider 'Charitable Purpose' in detail.

Meaning of Charitable Purpose

Charitable purpose has been defined in section 2(15) of the Income Tax Act, 1961 as follows:

"Charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility;

Thus, four activities are listed in the section, as shown in the graphic. Let us look at these in a little more detail:

1. Relief of the Poor

First of all, the relief must be directed at the poor from amongst the general public. It should not be intended for your own relatives or for a particular individual.

The word *poor* is not defined in the Act, and is, therefore, used in its commonly accepted sense of people who do not have money or property.

2. Education

The activity of education need not be restricted to the poor. But what is education itself?

Generally, education can mean:

- Systematic education, instruction, schooling or training to the young;
- Scholastic instruction as well as education necessary for

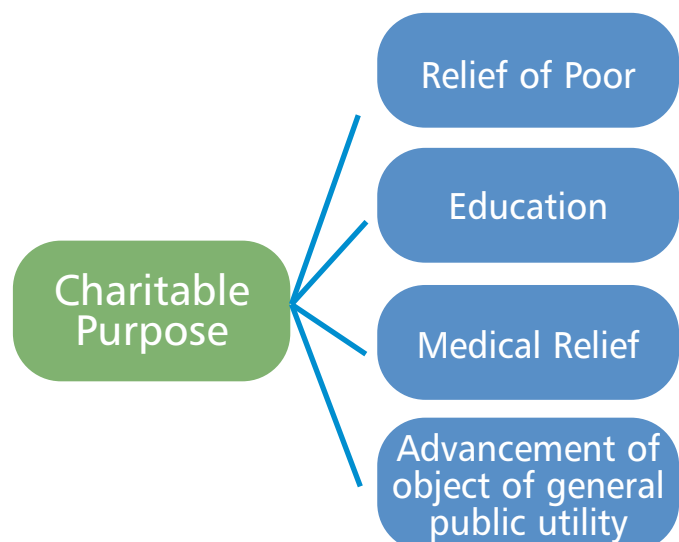
the work of life;

- Promotion of search for truth and diffusion of useful knowledge;
- Promotion of conferences and discussion.

However, this is too wide a meaning for the purposes of the Act. After all, education is a lifelong pursuit – even a pick-pocket 'educates' you about the dangers of carrying around large amounts of cash in your pocket!

In section 2(15), education connotes the process of developing the knowledge, skill, mind and character of students by normal schooling. Even coaching of the student in an institution is not treated as education for this purpose.

Education does not have to be provided free or at reduced rates to be eligible for the purpose of section 2(15).



¹ Section 10(23c)(iv)



3. Medical Relief

Medical relief involves the establishment and maintenance of medical facilities for the purposes of general public. It includes medical treatment of patients either with or without charges. Medical relief does not have to be philanthropic in terms of pricing of the services.

4. General Public Utility

This is the fourth and residuary part of the definition. It can include any activity which is seen as benefiting the public in general or is found useful for them.

As this part covers a large variety of activities, it has also been subject to frequent litigation. Some of these cases arose when business-like activities were taken up with charitable objectives.

The Battle with Business Activities

In recent decades, there has been a lively debate in the NGO sector on the issue of a developmental (or empowering) approach, vis a vis the charity approach. In general, the charity approach is seen to be simplistic or conservative, whereas the developmental approach is viewed as sophisticated and

modern.

This issue has also been agitating the Revenue officials, though from a completely different perspective.

Charitable Purpose versus Charitable Approach

The battle with businesses seeking to masquerade as charity has seen several rounds:

Round 1: The 1961 War

The basic definition emphasizes a charitable *purpose*, rather than actual charity. This led to a peculiar situation, as the then Finance Minister emphasized in his speech²:

“The process of widening the scope of charitable purpose was aided by another doctrine evolved by the courts that it is not a sary element in a charitable purpose that it should provide something for nothing or less than its cost or for less than the ordinary price, that is, *the charitable element is not essential for charitable purpose.*” [emphasis added]

² During the debate on the 1961 Act



As a result of this, even publishing a newspaper was treated as exempt from tax. The Minister argued that if this was allowed to continue, even a hotel could be claimed as exempt under the doctrine, as it provides shelter and food to tired travelers.

The freedom to run a business and apply its proceeds to charitable activities had been available since 1922. It was thus curtailed for the first time by the 1961 Act, which added the famous ten words to the definition of charitable purpose – ‘not involving the carrying on of any activity for profit’.

Round 2: The 1984 Treaty

Twenty years later, the Ministry relented somewhat. The phrase ‘not involving the carrying on of any activity for profit’ was deleted from the definition. However, the sentiment resurfaced in section 11(4A):

“[The exemption under section 11 shall not be available], unless–

- a. the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or is of a kind notified by the Central Government in this behalf in the Official Gazette; or
- b. the business is carried on by an institution wholly for

charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution, and separate books of account are maintained by the trust or institution in respect of such business.”

Round 3: The 1991 Peace Accord

In 1991, the Department relaxed the norms still further. The work could now be taken up by regular workers, rather than the beneficiaries. Also, it did not have to be solely for charitable purposes – it could simply be incidental to the pursuit of the NGO’s objectives. Moreover, the risk of taxation was restricted to the business income only – the entire income of the charity could not be taxed in any case. This is the way section 11(4A) stands at present:

“[The exemption under section 11 shall not be available for any business income], unless the business is incidental to the attainment of the objectives of the trust or, as the case may be, institution, and separate books of account are maintained by such trust or institution in respect of such business.”

The pleasant truce had lasted for just a decade, when skirmishes started again.

The Shome Committee Report



In the last two decades, three reports have touched upon the taxation of NPOs. These included the Parthasarthy Shome Report³.

This report made a radical recommendation. Any NPO which derived more than 10% of its income from sale of goods or services would be treated at par with commercial organisations. Such NPOs would be taxed like any other business.

The recommendation was, however, not implemented by the Government, till at least 2008.

Round 4: The War Bugle - 2008



³ Report of the Advisory Group on Tax Policy and Tax Administration for the Tenth Plan, May 2001

The draft budget, now placed in the Parliament, includes a proposal to tax some of the NPOs which receive any income from fees, cess, or sale of goods and services. This will be done by modifying the definition of 'charitable purpose' in section 2(15) to read as below:-

“charitable purpose” includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility:

Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity;

Note that the proposed proviso will affect only those NPOs which get their exemption under the fourth limb. It will not affect schools or hospitals, or trust which work directly with the poor. It will also not affect religious trusts.

Continued in AuditAble 3...

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Questions?: Your questions, comments and suggestions can be sent to AccountAid India, 55-B, Pocket C, Siddharth Extension, New Delhi-110 014; Phone: 011-2634 3128; Phone/Fax: 011-2634 3852; e-mail: accountaid@gmail.com.

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