

AuditAble

9. NPO Taxation under the proposed Tax Code - 3
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Situation in Other Countries

How do other countries deal with the issue of defining charitable purpose? Let us take a look at the tax laws in USA, the Mecca of philanthropy, and UK, our source of inspiration for most laws.

USA

Strangely enough, the language used in US Internal Revenue Code is quite specific, even though US Charities work in every imaginable sphere of philanthropy. Section 501(c)(3) runs as follows:

Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charita-

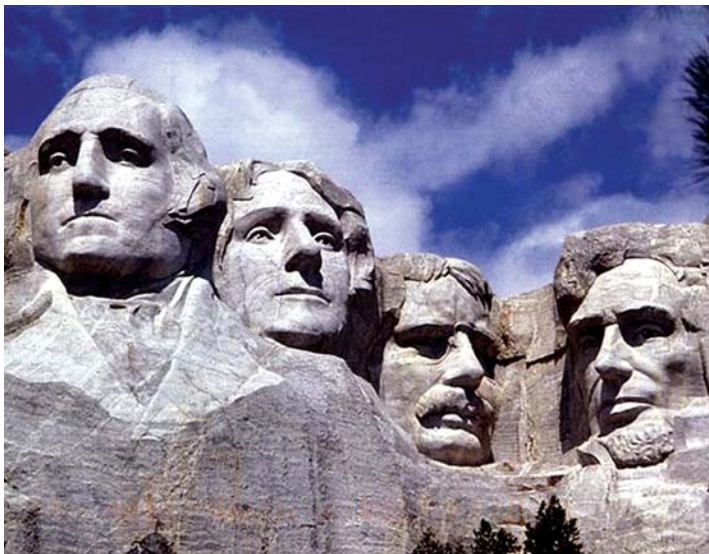
ble, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.

The word *charitable* occurring in the section above is used in the normal legal sense, and is taken to mean something dedicated to a general public purpose, usually for the benefit of needy people who cannot pay for benefits received (Black, 1999). It should be noted that the last phrase (italicised above) is missing in Indian law and legal decisions.

UK

For a long time, the meaning of charitable purpose was interpreted on the basis of the preamble¹ to the Statute of Charitable Uses Act, 1601. After sustained criticism of use of such an antiquated basis of defining charitable purpose, the Charities Act 2006 incorporated a clearer definition². As a result, the following activities are covered³, provided these are for public benefit:

- the prevention or relief of poverty;
- the advancement of education;
- the advancement of religion;
- the advancement of health or the saving of lives;
- the advancement of citizenship or community development;





- f) the advancement of the arts, culture, heritage or science;
- g) the advancement of amateur sport;
- h) the advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
- i) the advancement of environmental protection or improvement;
- j) the relief of those in need, by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- k) the advancement of animal welfare;
- l) the promotion of the efficiency of the armed forces of the Crown or of the police, fire and rescue services or ambulance services;
- m) other purposes currently recognised as charitable and any new charitable purpose which is similar to another charitable purpose.

It can be seen that the definition of charitable purpose in UK is quite specific. It also does not use an open-ended phrase like 'general public utility'.

The Indian Problem

Clearly then, the Indian law has been using a very wide and generous conception of charitable purpose. Interpreted loosely, it could include all the electricity companies, the railways and the airlines. If this is allowed, the Government would start losing tax revenue⁴. This seems to be the key reason for the Government trying to keep business-like activities out of the ambit of this clause⁵.

One workable solution to this problem could be to enlarge the list of legitimate welfare activities. This has already been

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done in a modest way by adding environment and monuments.

In addition to this, the general purpose object can also be modified by adding a phrase such as '...usually for the benefit of needy people who might not be able to pay for benefits received'.

2. Incidental Business Activity

In 2008, most modern NGOs were effectively disbarred from business activities, through changes made in sec. 2(15). This was relaxed a little bit in 2009, by allowing NPOs in two more categories to carry on business activities. Even so, such business had to be incidental to the main charitable purpose. This has often been interpreted to mean that running a business should not be the main objective. This interpretation allowed an NGO, for example, to sell greeting cards to raise funds for relief of the poor.

The code now narrows this down even further⁶. The business must now be carried on while actually undertaking the welfare activity.

So what happens to sale of greeting cards? This will be permitted if the cards are prepared by the poor themselves, and they earn a living out of it. If you get the cards printed at a press, it just might not be treated as incidental business activity.

Business Activities by Religious NPOs

Under the 2008 amendment, religious NPOs had been left out of the restriction on business activities. This meant that they could continue to enjoy tax exemption even if some of their activities involved generation of income. For example, income



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from sale of religious books, prasadam or fee from religious services would not disentitle them to the tax exemption.

The new code changes this. Incidental business activities are permitted only for categories 1-5⁷. It is unlikely that a religious NPO will ever be classified under any of these, as these categories are designed for welfare work. Most religious NPOs will be classified under category 6⁸. However, under this category, no business activity is permitted at all. This change may affect a large number of religious NPOs who charge for ashram facilities or sell religious literature⁹.



Clearly, the Tax Department has finally woken up to what Lord Jesus said 2000 years ago: *render unto Caesar...*¹⁰

3. Tax @ 15% on Unspent Funds

Presently NPOs are taxed at the maximum marginal rate (30%) if they fail to meet the minimum spending requirement of 85%. The code brings this tax rate down to 15% of taxable income¹¹. This taxable income essentially consists of unspent funds for the year and capital gains, as explained later on. The minimum spending requirement has simultaneously been raised to 100%.

Taxable Income

The formula for calculating taxable income in a financial year is: **Taxable Income = (gross welfare receipts - gross out-goings) + Capital gains from financial assets.**

The above components are discussed in the next issue of Auditable.

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Black. (1999). Black's Law Dictionary (7th ed.). (B. A. Garner, Ed.) St. Paul, Minnesota, USA: West Group.
Oxford. (2007). Shorter Oxford English Dictionary. (S. Angus, Ed.) New York: Oxford University Press.

¹ ...for relief of aged, impotent and poor people, some for Maintenance of sick and maimed Soldiers and Mariners, Schools of Learning, Free Schools and Scholars in Universities, ... for Repair of Bridges Ports Havens Causeways Churches Sea banks and Highways, ... for Education and preferment of Orphans, ... for or towards Relief Stock or Maintenance of Houses of Correction, ... for Marriages of poor Maids, ... for Support Aid and Help of young tradesmen Handicraftsmen and persons decayed, for relief or redemption of Prisoners or Captives, for aid or ease of any poor Inhabitants...

² Section 2, read with section 3

³ <http://www.charity-commission.gov.uk/spr/corcom1.asp#2>

⁴ Gujarat Maritime Board was denied tax exemption u/s 10(20) as a local authority. It then applied for registration as a Trust u/s 12A.

On denial of this registration, it contested the order successfully at the Tribunal and High Court level, following the rationale applied in CIT v. Andhra Pradesh State Road Transport Corpn. [1986] 159 ITR 1/25 Taxman 63A.

The Department's appeal was dismissed by the Supreme Court [Commissioner of Income-Tax vs. Gujarat Maritime Board [2008] 166 TAXMAN 58 (SC)].

This led to fears within the Government that a large number of organizations will follow the path taken by Gujarat Maritime Board. To pre-empt them, the Government immediately amended sec. 2(15).

⁵ By a curious coincidence, only Government Corporations have so far been able to successfully claim tax exemption under this clause!

⁶ Sec. 96(a): a business shall be incidental to the permitted welfare activity if the business is carried on in the course of the actual carrying out of the permitted welfare activity;

⁷ ...any activity,-

- (i) involving the relief of the poor;
- (ii) for the advancement of education;
- (iii) for providing medical relief;
- (iv) for the preservation of environment (including watersheds, forests and wildlife);
- (v) for the preservation of monuments or places or objects of artistic or historic interest;...

⁸ any activity...

(vi) for the advancement of any other object of general public utility;...

It may be possible for an NPO publishing only religious literature to claim classification under category ii, advancement of education. If this is accepted, it can continue selling books.

¹⁰ "Render unto Caesar the things which are Caesar's, and unto God the things that are God's." [Mathew 22:21, The Holy Bible]

¹¹ Sch. 1, paragraph C, read with sec. 87

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