



Not for Profit Organisations – Recent regulatory and tax developments

12 November 2021

Context

1 Not for profit Organizations (NPO) are typically housed in the format of Trusts, Societies or Section 8 Companies

- ▶ Objectives could be education, relief of the poor, medical relief etc. Includes religious organizations too

2 NPOs pursuing charitable activities are granted income-tax / GST exemptions, subject to conditions

3 The tax and regulatory environment for NPOs is changing requiring them to relook at their compliance and risk management framework in the future

4 In light of the above, we are discussing today, some of the key changes and its nuances in the tax environment, which are relevant for the operations of an NPO



- 1 Changing landscape for taxation of charities under Income-tax Act
- 2 Other relevant areas – FCRA, CSR
- 3 Q&A

Agenda

Overview of income-tax exemptions for NPOs

- NPOs are entitled to tax exemptions under the ITA u/s 10(23C) or 11-13 of the ITA based on the nature of activities
- General conditions applicable for section 10(23C) and section 11 of the ITA :-

Activities	Institutions should maintain not-for-profit status and engage in charitable activities
Charitable activities	Includes relief of the poor, education, yoga, medial relief, advancement of any other object of general public utility
Registration	Need to obtain approval from the tax authorities to be eligible for exemption
Application	Should apply atleast 85% of its income each year for its objects / charitable purposes
Other conditions	Genuineness of activities; Reasonableness in related party transactions; Compliance with laws material for its objectives; Invest accumulated funds in prescribed modes

- NPOs registered u/s 80G of the ITA entitle donors to a tax deduction [50-100%] on donations made

Tax amendments over recent years

Exemption for Corpus donation subject to certain conditions;

Manner of computing application of income in case of corpus funds or loan funds;

Excess application of past years shall not be allowed as application of income in future;

Enhancement in annual-receipt limit u/s.10(23C)

2021

2020

Change in registration process of charitable trust;

Filing of Statement by donee to cross-check claim of donation by Donor;

2019

Cancellation of registration on non-compliance with other laws material for achieving objects of the Trust

2018

Restrictive provisions on cash payments and non-deductibility of expenses as application on default in TDS deduction/ payment

2017

Corpus donations not application of income;

Change in objects require re-registration;

Power to survey NPOs to tax authorities.

2016

Tax on “accreted income” of the NPO at MMR upon conversion / merger / dissolution u/s 115TD of the ITA

Topical areas: Trigger of exit tax on accreted income u/s 115TD of the ITA

- Exit tax provisions introduced by the Finance Act, 2016
- When triggered “accreted income” of NPO shall be taxed @ Maximum Marginal Rate [42.744%]
- Exit tax is levied on NPO, if any of the below are triggered:
 - Cancellation of registration u/s 12AA or 12AB; or
 - Modification of objects which do not conform with the conditions of 12AA or 12AB registration;
 - Where application for fresh registration is not made, or if made rejected
 - Merger with an entity which does not have similar objectives & is not registered u/s 12AA or 12AB of ITA; or
 - Failure to transfer all assets upon dissolution to any other trust registered u/s 12AA/12AB/ 10(23C) of ITA within a period of 12 months.
- Accreted income is determined by reducing from the prescribed value of assets, the liabilities of the NPO
- Asset valuation norms prescribed, which broadly reflects fair market value (FMV) of assets
- In case of immovable property, FMV to be higher of purchase price of the property (if sold in the open market) on the basis of a valuation report* or stamp duty value on the specified date

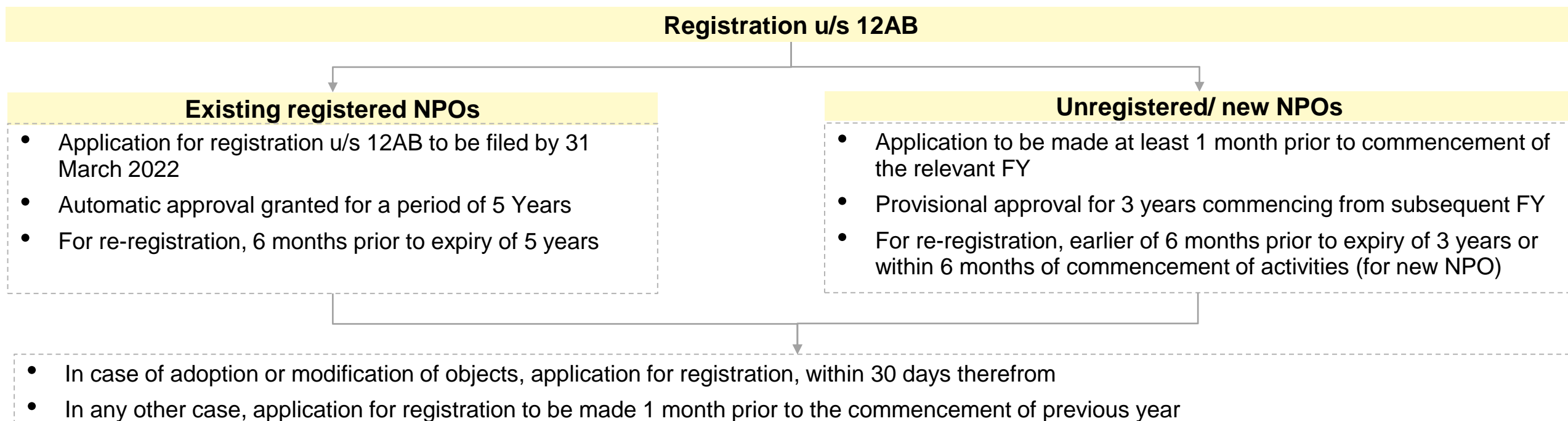
* Valuation report issued by a registered valuer

Topical areas: Cancellation of registration upon non-compliance of other laws

Power of tax authorities to cancel the registration upon non-compliance of any other law material for achieving the objects

- **At the time of renewal of registration**, the tax officer shall as per section 12AB(1)(b) -
 - call for such documents or information from the trust or institution or make such inquiries as he thinks necessary in order to satisfy himself about
 - the genuineness of activities of the trust or institution; and
 - the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects
 - Pass an order approving / cancelling the registration after giving an opportunity of being heard
- **Subsequent to passing an order granting the registration**, the tax officer may pass an order cancelling the registration after giving an opportunity of being heard, if it is noticed that
 - the trust or institution has not complied with the requirement of any other law, as referred to in 12AB(1)(b) and
 - the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality [Section 12AB(5)(b)]

1) New registration provisions u/s 12AB



Further, as per first proviso to section 11(7), for **NPOs having PARALLEL registrations** u/s 10(23C) / 10(46), registration u/s 12A/ 12AA shall stand inoperative automatically from 1 June 2020 and these institutions would be governed by section 10(23C) unless institutions choose to register themselves under section 12AB



1. Which regime is beneficial? 10(23C) vs 12AB?
2. Does non-filing of application within prescribed time lead to deemed cancellation of registration and hence, trigger exit tax?

**Time limit to apply for such re-registration has been extended to 31 March 2022 vide Circular No 16 / 2021 dated 29 August 2021*

Note: Similar amendments have been made in the registration process specified for charitable institutions covered under section 10(23C) and 80G of ITA

2) Registration: procedural / practical aspects [1/3]



- Application for registration in **Form No.10A** is required to be made by a charitable institution already registered under section 12A/12AA or by a “new” institution (not already registered)
- Registration order shall be issued in **Form 10AC** and automatic registration shall be granted without inquires for 5 years / 3 years
- However, **registration granted under Form 10AC and URN issued can be cancelled** in the following circumstances [Rule 2C(6) and Rule 17A(6)]:
 - Not providing information
 - Providing false / incorrect information
 - Not providing all / some documents required to be provided
 - Form No. 10A has not been furnished electronically as required under rule 2C(3) or 17A(3), as the case may be
 - Form No. 10A has not been duly verified as required under rule 2C(4) or 17A(3), as the case may be
- The cancellation may be effected **at any point of time.**
- If the registration / URN are cancelled, they shall be **deemed to have never been granted or issued.**
- The cancellation shall be effected only after giving the assessee an opportunity of being heard.
- The PCIT or CIT “**may**” **cancel the registration**



1. *Can exit tax be triggered upon cancellation of registration?*

3) Registration: procedural / practical aspects [2/3]



- As per Form 10AC [Sr. No 9(c)], the **order is liable to be “withdrawn”** if it is subsequently found that
 - i. the activities of the applicant are **not genuine**;
 - ii. the activities of the applicant are **not carried out in accordance with all or any of the conditions** subject to which it is granted;
 - iii. the applicant has obtained the registration **by fraud**;
 - iv. the applicant has obtained the registration by **misrepresentation** of facts;
 - v. the assessee has **violated any condition** prescribed in the Act.



1. *There is no concept of “withdrawal” in the Act for registration*
2. *Is the withdrawal discretionary or mandatory for the prescribed authority if one of the conditions in Sr. No. 9(c) is not satisfied?*
3. *Is there any time limit for withdrawal of registration?*
4. *Can an opportunity of being heard be read into the provision?*
5. *Can Exit tax under section 115TD be levied upon withdrawal of registration?*
6. *What is the meaning of “violated any condition prescribed in the Act”?*

4) Registration: procedural / practical aspects [3/3]



- As per Form 10AC [Sr. No 10], registration can be granted subject to conditions – sample order seems to contain 18 conditions
- Some conditions in orders issued are as below:
 - i. As and when there is a move to amend or alter the objects / **rules and regulations** of the applicant, prior approval of the CIT shall be sought along with the draft of the amended deed and no such amendment shall be effected until and unless the approval is accorded
 - ii. Separate accounts in respect of each **activity** as specified in Trust Deed / Memorandum of Association shall be maintained. A copy of such account shall be submitted to the Assessing Officer
 - iii. A public notice of the activities carried on / to be carried on and the **target group(s)** (intended beneficiaries) shall be duly displayed at the Registered / Designated Office of the Organisation.
 - iv. The Trust / Institution shall furnish a return of income every year within the time limit prescribed under the Income Tax Act, 1961.
 - v. The registered office or the **principal place of activity** of the applicant should not be transferred outside the jurisdiction of Jurisdictional Commissioner of Income Tax except with the prior approval.
 - vi. No asset shall be transferred **without the knowledge of Jurisdictional CIT** to anyone, including to any Trust / Society / Non Profit Company etc.
 - vii. All the Public Money so received including for Corpus or any contribution **shall be routed through a Bank Account whose number shall be communicated to Office of the Jurisdictional Commissioner of Income Tax**
 - viii. The applicant shall **comply with the provisions of the Income Tax Act, 1961** read with the Income Tax Rules, 1962.



1. *Can a view be taken that Form/ Rule cannot override the Act? [CIT v. Tulsyan NEC Ltd., (2011) 330 ITR 226 (SC)]*
2. *What are the remedies available for a tax payer?*

5) Conditional exemption of Corpus donations



- Corpus Donations are exempt from 85% application rule only if invested in permissible modes under section 11(5) and such investment is 'maintained specifically' for such corpus
 - Existing provisions under sec 13(1)(d) provides that all funds of the trust should remain invested in permissible modes under 11(5)
 - Intention appears to keep corpus funds intact from general funds
- New conditions not applicable to corpus donations received before 1st April 2021 – donations can remain to be invested in common pool and need not be earmarked
- Application out of corpus donations shall not be considered as application of income for charitable purposes. However, the application shall be allowed in the year in which such corpus is replenished



1. *Whether corpus donations can be deposited in a bank account mixed with other donations (general bank account)? Whether corpus donation is required to be invested at the time of initial receipt or at the end of the year may also be a valid compliance?*
2. *Application of the amended provisions for donations received in kind [plant & machinery, vehicle, etc.]*
3. *Is it required to be maintained for a reasonable period? – if the corpus donation received is utilized immediately, whether it will be considered as maintained in permissible mode?*

6) Repayment of loan – Application of income



- As per EM, it was noticed that charitable institutions take loans / borrowings and any spending out of that on objects of the trust is claimed as application for charitable purposes. Additionally, when such loans / borrowings are repaid, are again claimed as application of income, resulting in an unintended double deduction/ benefit.
- In order to curb this, amended provisions provide that:
 - application from loans and borrowings shall not be considered as application of income
 - amount of borrowing repaid out of income shall be treated as application of income in the previous year in which it is repaid
- Amendment effective from 1 April 2022 i.e. from AY 22-23



1. *Whether unpaid sundry creditors will be treated as loans?*
2. *What happens to a loan or borrowing effected before April 2021 and repaid after April 2021 – Can a view be taken that it is considered as application of income?*

7) Restriction on c/f and set off of excess application of past years



- Prior to amendment, there was no explicit provision in the scheme u/s section 11-13 or u/s 10(23C) of ITA dealing with implication of excess applications
- However, certain judicial precedents [CIT(E) v. Subros Educational Society, (2018) 96 taxmann.com 652 (SC)] permitted such set off excess application of past years' against the income for future years
- As per the amendment, no set off or deduction of any excess application money, of any of the preceding years shall be allowed for computation of income
- Amendment effective from 1 April 2022 i.e. from AY 22-23



1. *Where a vested right of taxpayer to carry forward excess application of FY 2019-20 and previous years is taken away by this amendment?*

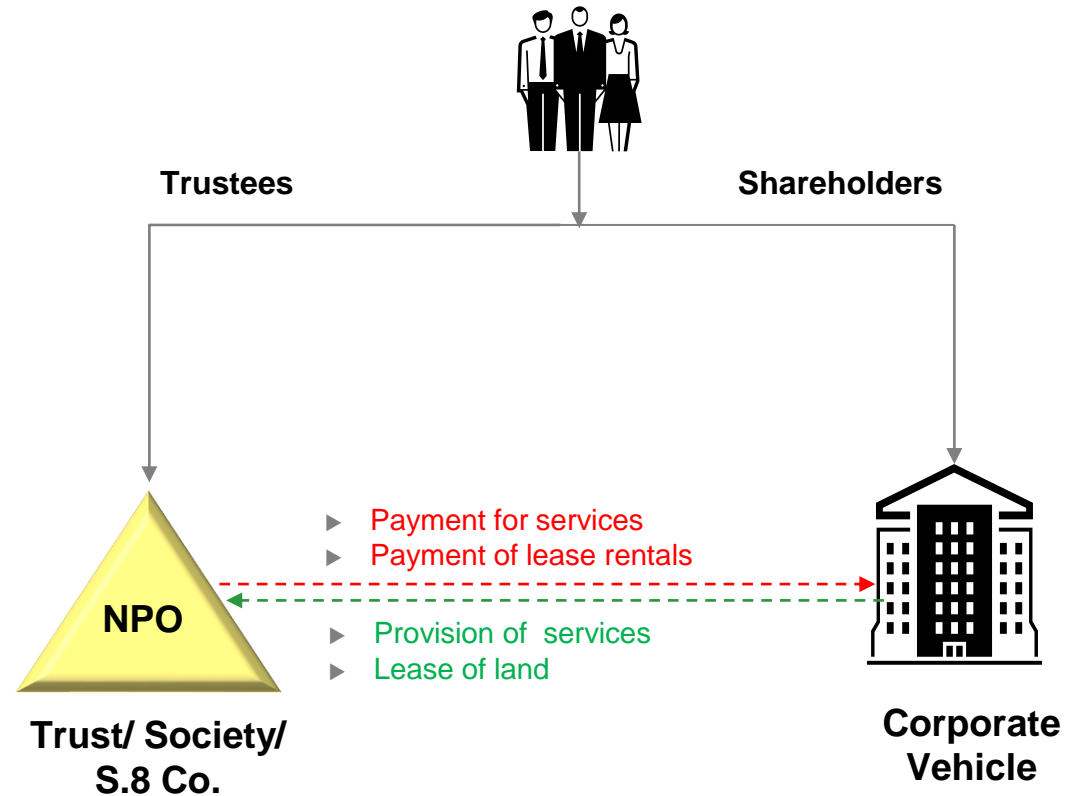
8) Increase in annual- receipt limit for small trusts



- Conditional exemption under 10(23C)(iiiad) and (iii ae) applies to educational and medical institutions without any need to obtain approval
- With a view to cover small educational and medical institutions, the monetary limit of annual receipt threshold has been increased from INR 1 crore to INR 5 crores
- The amendment is effective from 1 April 2022 i.e. AY 2022-23 and onwards

Other Topical areas: Reasonableness of RPT

“Reasonableness” of related party transactions



- Sec 13 of the ITA states conditions under which exemption u/s 11 is forfeited
- Includes providing direct/ indirect benefit to persons covered u/s 13(3) of the ITA
- S.13 not triggered if transaction is at ‘reasonable price’
- The term “reasonability” is not defined – reliance to be placed on judicial precedents*
- Important to identify related party transactions; maintain reasonability in pricing of transactions; have robust documentation

* Chirec Education Society V. ADIT (LAWS (APH)-2013-2-100); Shree Kamdar Education Trust V. ITO (2016 74 Taxmann 253 (Guj)); DCIT Vs. Sri Vekkallamman Educational & Charitable Trust (2014 52 Taxmann 139 (Chennai – Trib)); Hyndavi Educational Society V. ADIT (2012 27 Taxmann 8 (Hyd))”

Key takeaways

1 Put in place processes to comply with latest tax amendments

2 Review existing activities / MOUs to confirm that NPOs activities do not deviate from its objectives

3 Review compliances with material laws to achieve NPO objects

4 Identify related party transactions, and review if they are 'reasonable'; maintain supporting documentation

5 Undertake a health check / due diligence of the overall tax compliance status of the NPO

6 Immediate action to be taken for rectification of non-compliances

A close-up photograph of two people in white shirts sitting at a desk. One person is pointing at a document with their right hand, while the other is writing on it with a pen. The document contains some text and a small graphic with blue and red shapes. A large yellow rectangle is overlaid on the left side of the image, containing the text 'Other Areas'.

Other Areas

2

A) Key Amendments in FCRA

Key amendments	<div style="background-color: yellow; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin: 0 auto;">1</div> Prohibition on transfer of FC received by a FCRA registered person to another person	<div style="background-color: yellow; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin: 0 auto;">2</div> Cap on administrative expenses lowered from 50% to 20% of FC received in a financial year	<div style="background-color: yellow; border-radius: 50%; width: 40px; height: 40px; display: flex; align-items: center; justify-content: center; margin: 0 auto;">3</div> Designated FCRA bank account with SBI for receipt of FC
Potential impact	<ul style="list-style-type: none"> • Transfer of FC to other FCRA registered NPOs was permitted under the earlier law • Earlier structures involving nodal organizations receiving and transferring funds would be impacted as onward transfer of FC is now prohibited • NPOs need to consider the amendments in their FC structures as well as operating models and existing contractual agreements 	<ul style="list-style-type: none"> • Lowering of the cap on admin expenses could impact the quality/functioning of the NPOs • NPOs may need to segregate the amount of administrative expenditure vs amount of project cost on scientific basis to ensure that the threshold is not breached • Definition of “administrative expenses” under the FCRR to be carefully interpreted while segregating expenditure • Impact on funds flow for on-going projects to be considered 	<ul style="list-style-type: none"> • NPOs are required to open FCRA account with the SBI main branch • Centralizing of account opening could increase the overhead costs of NPOs • This change could further increase the transparency in fund flow and any non-compliances could be scrutinized closely by the authorities

Caution Point : For administrative ease, organizations to ensure that CSR contribution is not disbursed in FCRA account(s) of implementing agencies which is being regulated under FCRA.

B) Key Amendments to CSR framework

1

Mandatory ITA /MCA registrations for CSR Implementing Agencies

Anti-abuse / Digitization of records

2

Administrative Overheads

Clearly defined to mean expenses incurred by the company for 'general management and administration' of CSR functions

Limit of 5% of CSR spend.

3

Creation/ acquisition of assets

Restrictions on ownership of CSR assets (only by prescribed CSR vehicles or beneficiaries or public authority)

4

Surplus arising out of CSR activities

Mandated ploughing back into projects, transfers to Unspent CSR Account or prescribed Funds

5

Impact assessment

Mandated for projects of Rs 1 Cr or more and completed at least 1 year prior to Impact Assessment (for qualifying companies with average Rs 10 Cr obligation in past 3 FYs)

6

Carry forward and set-off of excess CSR spend

Permitted over next 3 FYs (CSR surpluses not covered)

7

Treatment of Unspent CSR

Mandated transfers from FY 21

Distinction between unspent amounts for 'On-going' and other projects

C) Other changes in Policy

Social Stock Exchanges

- Finance Minister ('FM') in the Union Budget speech of 2019, proposed creating an electronic fund raising platform – a social stock exchange ('SSE');
 - Objective is to list social enterprises and voluntary organizations and support them in fund raise
- SEBI expert panel has recently released a technical group report on SSE
- Key recommendations include (illustrative)
 - Activate and mainstream social capital to NPOs as zero coupon zero principal bonds listed on the SSE
 - Activate and mainstream existing funding structures – Social venture funds and Mutual funds
 - Implement common minimum reporting standards for reporting on social impact; governance and financials
 - Enable new funding mechanisms: pay-for-success (Social impact bonds; development impact bonds)
- Enabling regulatory mechanism needed to implement most recommendations

Source: FDI: Consolidated FDI Policy; Budget speech 2020

A close-up of a silver microphone with a mesh grille is positioned in the foreground. In the background, a blurred audience of people is seated at tables, suggesting a conference or meeting setting. A large, bright yellow circle is overlaid on the right side of the image, containing the word "Questions" in a bold, black, sans-serif font.

Questions