

# **Taxation of Cooperatives and NPO Sectors**



**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
**New Delhi**

# Taxation of Cooperatives and NPO Sectors

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**Committee for Co-operatives & NPO Sectors (CCONPO)**  
**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
New Delhi

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## Foreword

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The principle of cooperation is part and parcel of Indian Culture. Perhaps no other country in the world has the co-operative movement as large and as diverse as it is in India. Co-operatives & NPO sectors have been playing a distinct and significant role in the socio-economic development of the country. Country has seen substantial growth in these sectors during recent past and the same is expected to be maintained in future too, hence there is need for effective governance mechanism to monitor, manage the functioning and the performance of the cooperative Societies and NPO's Sectors.

I am pleased that Committee for Cooperatives & NPO Sectors (CCONPO) of the Institute of Chartered Accountants of India (ICAI) has come up with a book on taxation of cooperatives and not-for-profit organizations for assistance of members and other stakeholders. The book contains the legislative framework, taxation, tax benefits to NPO sector, circulars, notifications, forms under income tax laws, judicial decisions, and so on.

I congratulate CA. Vijay Kumar Garg, Chairman, CA. V. Murli, Vice-chairman, and other members of the CCONPO for publishing this book. I also compliment CA Brijesh Baranwal special invitee to the committee for drafting this document. The Committee has been taking initiatives to update the knowledge of the members and other stakeholders through various publications and conducting of seminars, workshops, etc. This publication is another step towards imparting knowledge in the field.

I wish all the readers a fruitful, professionally enriching experience from this publication. I hope readers will be greatly benefitted by this book.

Date: Jan 12, 2012

**CA. Jaydeep Narendra Shah**

Place: Delhi

President, ICAI



## PREFACE

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Cooperatives and non-profit organisations (NPOs) range from a large multi-national entity to a small community based self help group. NPOs may be in form of a corporation, a trust, a co-operative society or a foundation. A large number of registered as well as unregistered NPOs exist in India.

The changes in policies and de-regulation over the last two and a half decades have promoted urbanization and consumerism. In this scenario, the role of Cooperatives and NPO Sector has become indispensable in the process of development, particularly in the areas of health, education, human rights, self help and for enhancement of living standards and increasing overall well being of the citizens of the country.

In the above background, this publication is presented with a focus on the taxation of the Cooperatives and NPO Sector.

I would like to take this opportunity to place on record my deep appreciation to CA Brijesh Baranwal, Special Invitee, CCONPO who prepared the basic draft of this publication.

I compliment the members of Committee for Co-operative & NPO sectors for their valuable suggestions and comments.

I also thank CA Jaydeep Narendra Shah President, ICAI and CA Subodh Kumar Agrawal, Vice President, ICAI for their able guidance.

I wish to extend my sincere thanks to Dr. Amit Kumar Agrawal, Secretary, CCONPO and CA Ashish Tiwari, Executive Officer, CA Aakansha Nigam & CA Deepika Agrawal, Management Trainees, CCONPO who were instrumental in giving final shape to this document.

I am sure that this publication will be of great help to the reader.

Place: New Delhi

Date: 14-01-13

**CA Vijay Kumar Garg**  
Chairman  
Committee for Cooperatives & NPO



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# Chapter 1

## Cooperatives and NPO Sector: Legislative Framework

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### Cooperatives

A cooperative is a society registered or deemed to be registered under any law relating to cooperative societies for the time being in force in any State or under the Central act.

The Societies, whose main objectives are to serve the interests of its members in a particular State, are governed by the Cooperative Societies Act of that particular State. However, Societies whose main objectives are to serve the interests of its members in more than one State are governed by the Multi-State Cooperative Societies Act, 2002.

According to the Cooperative Societies Act of each State, a Cooperative Society registered within any State under the law of that State is not allowed to operate in other States without the permission of the Government or Registrar of Cooperative Societies of that State. In case of Multi-State Cooperative Society, it can operate in more than one State as a matter of right, under the Act and no permission of any State is required to do its business.

*Section 3(h) of the Multi-State Cooperatives Societies Act, 2002* defines a Cooperative Society as follows;

*"Cooperative Society" means a Society registered or deemed to be registered under any law relating to cooperative societies for the time being in force in any State".*

As per the *Wikipedia*;

*"A cooperative is an autonomous association of persons who voluntarily cooperate for their mutual social, economic, and cultural benefit."*<sup>1</sup>

Under *Section 2(19) of the Income Tax Act, 1961*, a co-operative society is defined as;

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<sup>1</sup> <http://en.wikipedia.org/wiki/Cooperative>.

*"A Cooperative society registered under the Co-operative Societies Act, 1912 or under any other law for the time being in force in any State for the registration of co-operative societies."*

Cooperatives are based on the cooperative values of "self-help, self-responsibility, democracy and equality, equity and solidarity".

Cooperatives are generally based on certain principles such as; Voluntary and open membership, Democratic member control, Member's Economic participation, Autonomy and independence, Education, training and information, Cooperation among cooperatives, and Concern for the community.

The above mentioned principles are provided in detail elsewhere in this paper.

## **Non- Profit Organisations (NPOs)**

Non-Profit Organisations (NPOs) are also known as Non-Government Organisations (NGOs) in India. However, NPOs include various, wholly or partly supported government organizations also, which work for the attainment of the good governance, social, economic and other purposes of the government. NPOs work for the under-privileged classes of the society. NPOs are primarily centered towards social & economic upliftment of underprivileged. However upliftment of underprivileged can not be construed as the only objective of NPOs.

Profit-earning is not the main purpose of NPOs. They provide services at almost free or negligible cost and these works are mostly charitable in nature.

*Wikipedia defines NPO in following words;*

*A nonprofit organization (NPO) is an organisation that uses surplus revenues to achieve its goals rather than distributing them as profit or dividends<sup>2</sup>.*

There are three main legal forms of NPOs under Indian laws i.e. trusts, societies, and companies incorporated under section 25 of the Companies Act, 1956 (section 25 companies). Many state and central government agencies have regulatory authority over these NPOs. For example, almost all NPOs are required to file tax returns and audited financial statements with various agencies. At the state level, these agencies include the Charity

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<sup>2</sup> [http://en.wikipedia.org/wiki/Nonprofit\\_organization](http://en.wikipedia.org/wiki/Nonprofit_organization).

Commissioner (for trusts), the Registrar of Societies (different titles referred to in some states including the Registrar of Joint Stock Companies), and the Registrar of Companies (for section 25 companies). At the national level, the regulatory bodies include the income tax department and for those NPOs which are in receipt of foreign contributions, it is Ministry of Home Affairs.

The main sources of funds for the NPOs are Government Grants, Donations, Fund raised through various programmes, subscriptions and membership fees etc.

## **Types of Organizations Falling within the Scope of NPOs**

### **1. Trusts**

Trusts may be classified as public trusts and private trusts. Public charitable trusts, as distinguished from private trusts, are designed to benefit members of an uncertain and fluctuating class. These are formed for a number of purposes, including the relief of poverty, education, medical relief, provision of facilities for recreation, and any other object of general public utility.

There is no Central law governing public charitable trusts in our country. However, these trusts are regulated to some extent.

Generally, at least two trustees are required to register a public charitable trust, though a trust may also have a single or sole trustee. In general, Indian citizens serve as trustees, although there is no specific prohibition against non-natural legal persons or foreigners serving in this capacity. Trustees of religious or charitable trusts are charged with discharging their duties with the degree of care that an ordinarily prudent person would exercise with respect to his personal property.

Legal title of the property of a public charitable trust vests in the trustees. Trustees of a public charitable trust may not, however, in any way use trust property or their position for their own interest or private advantage. Trustees may not enter into agreements in which they may have a personal interest that conflicts or may possibly conflict with the interests of the beneficiaries of the trust (whose interests the trustees are bound to protect). Trustees may not delegate any of their duties, functions or powers to a co-trustee or any other person, except that trustees may delegate ministerial acts. In essence, trustees may not delegate authority with respect to duties requiring the exercise of discretion.

## 2. Societies

Societies are governed by the Societies Registration Act, 1860, which is a Central Act. Many states, however, have enacted their own Societies Act with modifications.

Societies are similar in character to trusts, although there are a few essential differences. While only two individuals are required to form a trust, a minimum of seven individuals are required to form a society. The applicants must register the society with the relevant state's Registrar of Societies in order to be eligible for tax-exempt status. A registration application includes the society's memorandum of association and rules and regulations. In general, Indian citizens serve as members of the managing committee or governing council of societies, although there is no prohibition in the Societies Registration Act against non-natural legal persons or foreigners serving in this capacity.

Individuals or institutions or both may be members of a society. The general body of members delegates the management of day-to-day affairs to the managing committee, which is usually elected by the membership. Members of the general body of the society have voting rights and can demand the submission of accounts and the annual report of the society for inspection. Members of the managing committee may hold office for such period of time as may be specified under the bylaws of the society.

Societies, unlike trusts, are required to file a list of the names, addresses and occupations of their managing committee members annually with the Registrar of Societies. Furthermore, in a society all property is held in the name of the society, whereas all of the property of a trust legally vests in the trustees.

Unlike trusts, societies may be dissolved. Dissolution must be approved by at least three-fifths of the society's members. Upon dissolution, and after settlement of all debts and liabilities, the funds and property of the society may not be distributed among the members of the society. Rather, the remaining funds and property must be given or transferred to some other society, preferably one with similar objects as the dissolved entity.

According to Section 20 of the Act, the types of societies that may be registered under the Act include, but are not limited to, the following:

- Charitable societies;
- Societies established for the promotion of science, literature, education, or the fine arts; and

- Public art museums and galleries, and certain other types of museums etc.

### 3. Section 25 Companies

The Indian Companies Act, 1956, permits certain companies to obtain not for profit status as "section 25 companies."

A section 25 company is a company with limited liability that may be formed for "promoting commerce, art, science, religion, charity or any other useful object," provided that no profits, if any or other income derived through promoting the company's objects may be distributed in any form to its members. A section 25 company must apply its profits, if any, or other income to the promotion of its objects, and should not pay any dividend to its members.

At least three individuals are required to form a section 25 company. The founders or promoters of a section 25 company are required to submit application to the Regional Director along with the copies of the Memorandum and articles of association of the proposed company, as well as a number of other documents, including a statement of assets and a brief description of the work proposed to be done upon registration.

The internal governance of a section 25 company is similar to that of a society. It generally has members and is governed by directors or a managing committee or a governing council elected by its members.

Like a society (but unlike a trust), a section 25 company may be dissolved. Upon dissolution and after settlement of all debts and liabilities, the funds and property of the company may not be distributed among the members of the company. Rather, the remaining funds and property must be given or transferred to some other section 25 company, preferably one having similar objects as the dissolved entity.

## Formation of Cooperatives and NPOs with legal status

The right of all citizens to form associations or unions is guaranteed by the Constitution of India by Article 19(1) (c).

It provides the right to form associations and unions in the following words;

*"Protection of certain rights regarding freedom of speech, etc.—*

(1) *All citizens shall have the right—*

(c) *to form associations or unions;"*

Further Article 30 of the Constitution of India gives all "minorities"<sup>3</sup>, whether based on religion or language, the right to establish and administer educational institutions of their choice in the following words;

*"30. (1) All minorities, whether based on religion or language, shall have the right to establish and administer educational institutions of their choice."*

## **Formation of Cooperatives and NPOs**

### **Formation of Cooperatives**

Cooperative societies may be governed by the Cooperative Societies Act, 1912 or respective State Cooperative Societies Act or by the Multi-State Cooperative Societies Act, 2002.

#### ***The Cooperative Societies Act, 1912***

The preamble of the Cooperative Societies Act, 1912 seeks to facilitate the formation of Co-operative Societies for the promotion of thrift and self-help among agriculturists, artisans and persons of limited means.

The Cooperative Societies Act, 1912 is a Central legislation and State Government's have enacted more or less similar laws in their respective states with some exceptions in some particular States. Some of the important sections of Cooperative Societies Act, 1912 are given hereunder for an overall understanding on the subject.

Some important provisions of the Cooperative Societies Act, 1912 are as under:

Section 2, clause (e) defines a "registered society" in the following words;

*"registered society"* means a society registered or deemed to be registered under this Act.

As per Section 3, the State Government may appoint a person to be Registrar of Co-operative Societies.

Section 4 provides that a society which has as its object, the promotion of the economic interests of its members in accordance with co-operative principles, or a society established with the object of facilitating the operations of such a society, may be registered under this Act with or without limited liability.

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<sup>3</sup> *"Minority" may be defined as those groups that wish to preserve stable ethnic, religious or linguistic traditions or characteristics markedly different from those of the rest of the population.*

Section 5 puts some restrictions on the interest of members of society with limited liability and a share capital. It says that where the liability of the members of a society is limited by shares, no member other than a registered society shall-

- (a) hold more than such portion of the share capital of the society, subject to a maximum of one-fifth, as may be prescribed by the rules; or
- (b) have or claim any interest in the shares of the society exceeding one thousand rupees.

Conditions of registration are provided in Section 6 and the same is reproduced hereunder for ease of reference:

- “(1) No society, other than a society of which a member is a registered society, shall be registered under this Act which does not consist of at least ten persons above the age of eighteen years and, where the object of the society is the creation of funds to be lent to its members, unless such persons:
  - (a) reside in the same town or village or in the same group of villages; or
  - (b) save where the Registrar otherwise directs, are members of the same tribe, class, caste or occupation.
- (2) The word "limited" shall be the last word in the name of every society with limited liability registered under this Act.”

Section 7 gives power to the Registrar to decide certain question. It says that when any question arises whether for the purposes of this Act a person is an agriculturist or a non-agriculturist, or whether any person is a resident in a town or village or group of villages, or whether two or more villages shall be considered to form a group, or whether any person belongs to any particular tribe, class, caste or occupation, the question shall be decided by the Registrar, whose decision shall be final.

Section 8 provides for the application for registration in the following manner:

- (1) For purposes of registration an application to register shall be made to the Registrar.
- (2) The application shall be signed-
  - (a) in the case of a society of which no member is a registered society, by at least ten persons qualified in accordance with the requirements of section 6, sub-section (1); and

- (b) in the case of a society of which a member is a registered society, by a duly authorized person on behalf of every such registered society, and where all the members of the society are not registered societies, by ten other members or, when there are less than ten other members, by all of them.
- (3) The application shall be accompanied by a copy of the proposed by-laws of the society, and the persons by whom or on whose behalf such application is made shall furnish such information in regard to the society as the Registrar may require.

As per Section 9, If the Registrar is satisfied that a society has complied with the provisions of this Act and the rules and that its proposed by-laws are not contrary to the Act or to the rules, he may, if he thinks fit, register the society and its by-laws.

Section 10 provides that a certificate of registration signed by the Registrar shall be conclusive evidence that the society therein mentioned is duly registered unless it is proved that the registration of the society has been cancelled.

Section 47(1) provides that no person other than a registered society shall trade or carry on business under any name or title of which the word "co-operative" is part without the sanction of the State Government. However, this provision further provides that nothing in this section shall apply to the use by any person or his successor in interest of any name or title under which he traded or carried on business at the date on which this Act comes into operation.

### ***The Multi-State Cooperative Societies Act, 2002***

As per the preamble of the above mentioned Act, "This is an Act to consolidate and amend the laws relating to cooperative societies, with objects not confined to one State and serving the interests of members in more than one State, to facilitate the voluntary formation and democratic functioning of cooperatives as people's institutions based on self-help and mutual aid and to enable them to promote their economic and social betterment and to provide functional autonomy and for matters connected therewith or incidental thereto."

Some important provisions of the Multi-State Cooperative Societies Act, 2002 are as follows:

Section 2 provides that this Act shall apply to:

- (a) all cooperative societies, with objects not confined to one State which were incorporated before the commencement of this Act
  - (i) under the Cooperative Societies Act, 1912, or
  - (ii) under any other law relating to cooperative societies in force in any State or in pursuance of the Multi-unit Cooperative Societies Act, 1942 or the Multi-State Cooperative Societies Act, 1984 and the registration of which has not been cancelled before such commencement; and
- (b) all multi-State cooperative societies.

As per Section 3(h), "*cooperative society*" means a society registered or deemed to be registered under any law relating to cooperative societies for the time being in force in any State;

As per Section 3 (p) "*multi-state cooperative society*" means a society registered or deemed to be registered under this Act and includes a national cooperative society and a Federal cooperative;

Section 3 (q) defines "*multi-state cooperative society with limited liability*" as "a society having the liability of its members limited by its bye-laws to the amount, if any, unpaid on the shares, respectively, held by them or to such amount as they may, respectively, thereby undertake to contribute to the assets of the society, in the event of its being wound up".

As per Section 5 (1) No multi-state cooperative society shall be registered under this Act, unless,

- (a) its main objects are to serve the interests of members in more than one state; and
- (b) its bye-laws provide for social and economic betterment of its members through self-help and mutual aid in accordance with the cooperative principles.

Section 6 and 7 provides for the registration under this Act and Section 8 stipulates that where a multi-state cooperative society is registered under this Act, the Central Registrar shall issue a certificate of registration signed by him, which shall be conclusive evidence that the society therein mentioned is duly registered under this Act, unless it is proved that the registration of the society has been cancelled.

As per Section 9, Multi-state cooperative society shall be body corporate. It stipulates as under:

- “(1) The registration of a multi-state cooperative society shall render it a body corporate by the name under which it is registered having perpetual succession and a common seal, and with power to acquire, hold and dispose of property, both movable and immovable, enter into contract, institute and defend suits and other legal proceedings and to do all things necessary for the purpose for which it is constituted, and shall, by the said name, sue or be sued.
- (2) All transactions entered into in good faith prior to the registration of a multi-state cooperative society shall be deemed to be its transactions after registration for furtherance of the objects of its registration.”

As per Section 16 (1), No multi-state cooperative society with unlimited liability shall be registered after the commencement of this Act.

Section 21 provides for the cancellation of registration certificate of multi-state cooperative societies in certain cases.

Sections 70 to 83 contained in Chapter VIII provide for the Audit, Inquiry and Inspection etc.

Section 86 provides for the winding up of multi-state cooperative societies in certain cases.

The Act contains two schedules also along with the abovementioned provisions.

## **The First Schedule**

The First Schedule of the Act provides seven cooperatives principles which are as given hereunder:

### **1. Voluntary and Open Membership**

Cooperatives are voluntary organisations, open to all persons capable of using their services and willing to accept the responsibilities of membership, without discrimination on bases of gender, social inequality, racial, political ideologies or religious consideration.

### **2. Democratic Member Control**

Cooperatives are democratic organisations controlled by their members, who actively participate in setting their policies and decision making. Elected representatives of these cooperatives are responsible and accountable to their members.

### **3. Member's Economic Participation**

Members contribute in equal proportion and control the capital of their cooperative democratically. At least a part of the surplus arising out of the economic results would be the common property of the cooperatives. The remaining surplus could be utilised benefiting the members in proportion to their share in the cooperative.

### **4. Autonomy and Independence**

Cooperatives are autonomous, self-help organisations controlled by their members. If cooperatives enter into agreement with other organizations including Government or raise capital from external sources, they do so on terms that ensure their democratic control by members and maintenance of cooperative autonomy.

### **5. Education, Training and Information**

Cooperatives provide education and training to their members, elected representatives and employees so that they can contribute effectively to the development of their cooperatives. They also make the general public, particularly young people and leaders aware of the nature and benefits of cooperation.

### **6. Cooperation among Cooperatives**

Cooperatives serve their members most effectively and strengthen the cooperative movement, by working together through available local, regional, national and international structures.

### **7. Concern for Community**

While focusing on the needs of their members, cooperatives work for the sustainable development of communities through policies accepted by their members.

The Second schedule contains names of National Level Multi-Cooperative Societies.

## **Formation of NPOs**

In India, an NPO can be formed with legal status in the following ways;

1. Registration under the provisions of the Societies Registration Act, 1860,
2. Registration under the provisions of the Indian Trusts Act, 1882,
3. Registration under Section 25 of the Companies Act, 1956.

### ***Societies Registration Act, 1860***

*This is an Act for the registration of literary, scientific and charitable societies and improving the legal condition of societies established for the promotion of literature, science, or the fine arts, or for the diffusion of useful knowledge, the diffusion of political education, or for charitable purposes;*

Charitable purposes can be grouped into four heads:

- (i) *relief of poverty,*
- (ii) *education,*
- (iii) *advancement of religion and*
- (iv) *other purposes beneficial to the community not coming under any of the preceding heads.*

Some important provisions of the Societies Registration Act, 1860 are as follows:

Section 1 provides for the formation of societies by the Memorandum of association and registration thereof in the following words:

*"Any seven or more persons associated for any literary, scientific, or charitable purpose, or for any such purpose as is described in section 20 of this Act, may, by subscribing their names to a memorandum of association, and filing the same with Registrar of Joint-stock Companies form themselves into a society under this Act."*

Section 2 provides for the Memorandum of association. It says that the memorandum of association shall contain the following things-

- the name of the society;
- the object of the society; and
- the names, addresses, and occupations of the governors, council, directors, committee, or other governing body to whom, by the rules of the society, the management of its affairs is entrusted.

It further says that, a copy of the rules and regulations of the society, certified to be a correct copy by not less than three of the members of the governing body, shall be filed with the Memorandum of association.

Section 3 provides for registration and fees. It says that upon such Memorandum and certified copy being filed, the Registrar shall certify under his hand that the society is registered under this Act. There shall be paid to the Registrar for every such registration a fee of fifty rupees, or such smaller

fees as the State Government may from time to time, direct; and all fees so paid shall be accounted for to the State Government.

As per Section 20, the following societies may be registered under this Act:

Charitable societies, the military orphan funds or societies established at the several presidencies of India, societies established for the promotion of science, literature, or the fine arts for instruction, the diffusion of useful knowledge, the diffusion of political education, the foundation or maintenance of libraries or reading-rooms for general use among the members or open to the public or public museums and galleries of paintings and other works of art, collections of natural history, mechanical and philosophical inventions, instruments, or designs.

### ***Indian Trusts Act, 1882***

Section 3 of the Indian Trusts Act, 1882 contains interpretation clause. Some important terms defined under Section 3 of the Act are as under:

*Trust* - A "trust" is an obligation annexed to the ownership of property, and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner.

*"Author of the trust"*- the person who reposes or declares the confidence.

*"Trustee"*- the person who accepts the confidence.

*"Beneficiary"*- the person for whose benefit the confidence is accepted.

*"Trust-property" or "trust-money"*- the subject-matter of the trust.

As per Section 4, a trust may be created for any lawful purpose. The purpose of a trust is lawful unless it is:

- (a) forbidden by law, or
- (b) is of such a nature that, if permitted, it would defeat the provisions of any law, or
- (c) is fraudulent, or
- (d) involves or implies injury to the person or property of another, or
- (e) the court regards it as immoral or opposed to public policy.

It further provides that, every trust of which the purpose is unlawful is void. And where a trust is created for two purposes, of which one is lawful and the other unlawful, and the two purposes, cannot be separated, the whole trust is void.

Section 5 provides that, no trust in relation to immovable property is valid unless declared by a non-testamentary instrument in writing signed by the author of the trust or the trustee and registered or by the will of the author of the trust or of the trustee.

It further says that no trust in relation to movable property is valid unless declared as aforesaid, or unless the ownership of the property is transferred to the trustee. These rules do not apply where they would operate so as to effectuate a fraud.

As per Section 6, a trust is created when the author of the trust indicates with reasonable certainty by any words or acts:

- (a) an intention on his part to create thereby a trust,
- (b) the purpose of the trust,
- (c) the beneficiary, and
- (d) the trust-property, and (unless the trust is declared by will or the author of the trust is himself to be the trustee) transferred the trust-property to the trustee.

### ***Section 25 of the Companies Act, 1956***

A section 25 company can be established 'for promoting commerce, art, science, religion, charity or any other useful object', provided the profits, if any, or other income is applied for promoting only the objects of the company and no dividend is paid to its members. These companies are granted a licence by the Central government recognizing them as such.

Section 25 of the Companies Act, 1956 has been reproduced hereunder for ease of reference:

#### **"Section 25 - Power to dispense with "Limited" in name of charitable or other company**

- (1) Where it is proved to the satisfaction of the Central Government that an association—
  - (a) is about to be formed as a limited company for promoting commerce, art, science, religion, charity or any other useful object, and
  - (b) intends to apply its profits, if any, or other income in promoting its objects, and to prohibit the payment of any dividend to its members,

The Central Government may by licence, direct that the association may be registered as a company with limited liability, without the addition to its name of the word "Limited" or the words "Private Limited".

- (2) The association may thereupon be registered accordingly; and on registration shall enjoy all the privileges, and (subject to the provisions of this section) be subject to all the obligations, of limited companies.
- (3) Where it is proved to the satisfaction of the Central Government—
  - (a) that the objects of a company registered under this Act as a limited company are restricted to those specified in clause (a) of sub-section (1), and
  - (b) that by its constitution the company is required to apply its profits, if any, or other income in promoting its objects and is prohibited from paying any dividend to its members.

The Central Government may, by licence, authorize the company by a special resolution to change its name, including or consisting of the omission of the word "Limited" or the words "Private Limited"; and section 23 shall apply to a change of name under this sub-section as it applies to a change of name under section 21.

- (4) A firm may be a member of any association or company licensed under this section, but on the dissolution of the firm, its membership of the association or company shall cease.
- (5) A licence may be granted by the Central Government under this section on such conditions and subject to such regulations as it thinks fit, and those conditions and regulations shall be binding on the body to which the licence is granted, and where the grant is under sub-section (1), shall, if the Central Government so directs, be inserted in the memorandum, or in the articles, or partly in the one and partly in the other.
- (6) It shall not be necessary for a body to which a licence is so granted to use the word "Limited" or the words "Private Limited" as any part of its name and unless its articles otherwise provide, such body shall, if the Central Government by general or special order so directs and to the extent specified in the direction, be exempt from such of the provisions of this Act as may be specified therein.
- (7) The licence may at any time be revoked by the Central Government, and upon revocation, the Registrar shall enter the word "Limited" or the words "Private Limited" at the end of the name upon the register of

the body to which it was granted; and the body shall cease to enjoy the exemption granted by this section:

Provided that, before a licence is so revoked, the Central Government shall give notice in writing of its intention to the body, and shall afford it an opportunity of being heard in opposition to the revocation.

- (8) (a) A body in respect of which a licence under this section is in force shall not alter the provisions of its Memorandum with respect to its objects except with the previous approval of the Central Government signified in writing.
- (b) The Central Government may revoke the licence of such a body if it contravenes the provisions of clause (a).
- (c) In according the approval referred to in clause (a), the Central Government may vary the licence by making it subject to such conditions and regulations as that Government thinks fit, in lieu of, or in addition to, the conditions and regulations, if any, to which the licence was formerly subject.
- (d) Where the alteration proposed in the provisions of the Memorandum of a body under this sub-section is with respect to the objects of the body so far as may be required to enable it to do any of the things specified in clauses (a) to (g) of sub-section (1) of section 17, the provisions of this sub-section shall be in addition to, and not in derogation of, the provisions of that section.
- (9) Upon the revocation of a licence granted under this section to a body the name of which contains the words "Chamber of Commerce", that body shall, within a period of three months from the date of revocation or such longer period as the Central Government may think fit to allow, change its name to a name which does not contain those words; and—
- (a) the notice to be given under the proviso to sub-section (7) to that body shall include a statement of the effect of the foregoing provisions of this sub-section; and
- (b) section 23 shall apply to a change of name under this sub-section as it applies to a change of name under section 21.
- (10) If the body makes default in complying with the requirements of sub-section (9), it shall be punishable with fine which may extend to five thousand rupees for every day during which the default continues."

## Procedure for Formation of Section 25 Companies

An application in e-form 1A has to be made to the Registrar of Companies for availability of name, with a fee of ₹ 1,000/-. After the availability of name is confirmed, an application is made in writing to the Regional Director of the Company Law Board for granting license under this section. The application must include copies of the memorandum and articles of association of the proposed company, as well as a number of other documents, including a statement of assets and a brief description of the work proposed to be done upon registration. The applicants are required to publish a notice in the prescribed manner at least once in at least two news papers. One notice should be in an English newspaper circulating in that district and in a language of the district in which the registered office of the proposed company is to be situated or is situated and circulating in that district.

If the Registrar is satisfied that the application is complete in all respects and in the best interest of the country, regional director can grant the licence under this section with or without conditions and may also direct the company to insert in its memorandum, or in its articles, or in both, such conditions of the licence as may be specified by him in this behalf. After obtaining licence under section 25, the company shall be formed as a normal company and the other formalities of incorporation shall be complied with.

One important feature of this form of organization is that, the shares and other interest of any member in the Company shall be a movable property and can be transferable in the manner provided by the Articles, which is otherwise not easily possible in other forms. Therefore, it is easier to become or leave the membership of the Company or otherwise it is easier to transfer the ownership.

## Chapter 2

# Taxation of the Cooperatives and NPO Sector

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Charity<sup>4</sup> is a human instinct that drives man to think favourably of others and do them good. In our country the benevolent role played by charitable and religious trusts has a historical background and their existence has originated from the basic cultural traits peculiar to us.

The Direct Taxes Enquiry Committee, in its final report published in December, 1971, had observed that "by tradition, private philanthropy in our country has been playing a very special and prominent role in enriching our cultural heritage and in catering to the education, medical, socio-economic and religious needs of our people. In so doing, it has supplemented the work of a Welfare State, and the State, in turn has recognized its contribution by giving generous tax treatment to the donations given to philanthropic institutions and also to the income thereof applied for public, religious or charitable purposes." In 1860 when income-tax was first introduced in India, "income from the property solely employed for religious or public charitable purposes" was exempt from the tax.

Since then, although the Income-tax Act was amended from time to time on innumerable occasions, the income derived from property held for charitable or religious purposes always enjoyed exemption from tax net.

Altruism is the noblest of human attributes. But at the same time, selfishness is the main spring of the human actions. It was observed by the Direct Taxes Enquiry Committee that there is no good cause which human ingenuity cannot defile and experience has shown that even in our country, these altruistic media have been abused with impunity for selfish personal ends. Since the tax concessions afforded to these institutions involve a sacrifice of public revenues, it became imperative to ensure that tax privileges are not abused and they are enjoyed only by those charitable and religious institutions, which deserve them<sup>5</sup>.

With this end in view, the sections in the Income-tax Act, dealing with this subject, underwent major changes in several respects in the following years.

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<sup>4</sup> *Taxation of Charitable Trusts and Institutions - A Study by ICAI, Page-2.*

<sup>5</sup> *Ibid.*

In fact, it is a matter of considerable importance to study the provisions of law governing the conditions and circumstances which, when satisfied, would entitle Cooperatives and NPO Sector to enjoy exemption from tax.

India's tax laws for Cooperatives and NPOs are to a large extent similar to the tax laws of many other Commonwealth nations. Taxation laws and exemptions etc. for Cooperatives and NPOs have been discussed in this chapter in detail.

The income of certain NPOs carrying out specific types of activities is exempt from corporate income tax, with the condition that unrelated business income is subject to tax under certain circumstances.

The income tax laws provide tax benefits for donors also. This benefit requires the satisfaction of some conditions.

NPOs involved in relief work and in the distribution of relief supplies to the needy are 100% exempt from Indian customs duty on the import of items such as food, medicine, clothing and blankets etc.

Before going for the discussion regarding taxation of cooperatives and NPO sector, in detail, it is suitable to refer to the decision of the Hon'ble Supreme Court in the case of Ajax Products Ltd.(AIR 1965 SC 1358). Hon'ble Supreme Court in the above mentioned case, regarding the taxability or otherwise of any particular item of income, opined in following words:

*"The subject cannot be charged to tax unless the charging provision of a taxing statute clearly imposes the obligation."*

## **Provisions for Taxation of a Cooperative Society**

A cooperative society may be formed for producing, procuring and selling the agriculture produce or other goods of its members, or a cooperative society may be formed in providing credit facilities to its members or any other such activities<sup>6</sup>.

In India, the Cooperative Societies have always enjoyed concessional treatment for the purposes of Income tax. However, every cooperative Society like every other assessee has to compute the income under different heads and then look for permissible deductions. The taxation of Cooperative Societies revolves around two aspects.

- (i) Class of Income

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<sup>6</sup> "Urban cooperative banks-Income tax problems in cooperative banking - its effects in working of cooperative banks", 2000, L.R. Journal/47, Page 737.

(ii) Concept of Mutuality

As per Section sec.2 (19) of the Income Tax Act, 1961, a Co-operative society means a society registered under the Co-operative Societies Act, 1912 or under any other law for the time being in any state for the registration of co-operative societies. For the purpose of the income tax act, a regional rural bank is deemed to be a co-operative society as per circular no. 319 dated 11, 1982.

A Cooperative Society under the Act is to be treated as an association of persons (AOP), which is included in the definition of 'person' under the Income Tax Act, 1961.

A Cooperative Society is taxed at rates, which are different from those applicable to an AOP. Under the annual Finance Act, though individuals, Hindu undivided family, AOP or body of individuals, whether incorporated or not, or every artificial juridical person referred to in the Income Tax Act, are chargeable at rates prescribed in paragraph A, of the Finance act. A Cooperative society is chargeable to tax as per rates prescribed under paragraph B of Part 1 of the first schedule to the annual Finance Act.

The amount of income tax computed in accordance with the provisions of the Act shall in the case of every cooperative society, be increased by a surcharge as prescribed in each of the Finance Acts.

The following rates are applicable to a Cooperative Society for the Assessment Year 2012-13 and 2013-14.

| <i>Net Income Range</i> | <i>Rate of Income Tax (in percent)</i> |
|-------------------------|--|
| Up to ₹ 10,000          | 10                                     |
| ₹ 10,000 to ₹ 20,000    | 20                                     |
| ₹ 20,000 and above      | 30                                     |

### **Computation of the Taxable Income of a Cooperative Society**

- First of all, the total income under the different heads i.e. income from house property, profits or gains of business or profession, capital gains, and income from other sources is computed and thus the gross total income is obtained.
- While computing the gross total income, income exempt from tax under section 10, if any is ignored.

- Now, from the amount arrived as above, the permissible deductions e.g. deductions under section 80G, 80GGA, 80GGC, 80-IA, 80-IB, 80IC, 80JJA and 80P are made and thus obtained the net income.
- To the net income so arrived at, the rates of tax as per the Finance Act for the respective year is applied to cooperative society.
- Now to the amount of tax, percent of income tax as surcharge prescribed in the Finance Act is added.

## **Special Provision for Cooperatives - Section 80p under the Income Tax, 1961**

Apart from getting the benefit of concessional rate of tax on their chargeable income under the annual Finance Act, the Cooperative Societies are also entitled to several other concessions, in the computation of their taxable income, of which Section 80P is of special relevance.

### Section 80P

Section 80P is a very special section for the growth and development of cooperative movement in India. This section is applicable to a cooperative society only. There are different heads of deductions enumerated in the section and each is distinct and independent of the other. To decide whether a particular category of income of a cooperative society is to be exempted from tax, it shall have to be seen whether it falls under the said head/s or not. The deductions allowable under this section are in respect of net incomes from the activities or businesses, specified in the various clauses of the section.

If a Cooperative Society carries on such activities, income from which is exempt and also carries on such activities, income from which is not exempt, then profits/gains attributable to former activity shall enjoy exemption and those attributable to later one shall be taxed. Where a Cooperative Society earns income, which is partly taxed and partly entitled to special deduction, proportionate share of the expenses attributable to the earning of income, entitled to deduction, should be deducted in computing such income.

The following amounts are allowed as deduction under Section 80P. However, from the assessment year 2007-08 onwards, deduction under this section is not available to a cooperative bank. Deduction under Section 80P is available to a primary agricultural credit society, a primary co-operative agricultural society and also to a rural development bank.

## Taxation of Cooperatives and NPO Sectors

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The whole of the amount of the profits attributable to any one or more of the following activities in the case of a co-operative society engaged in following activities shall be allowed as deduction-

- carrying on the business of banking or providing credit facilities to its member,
- a cottage industry,
- the marketing of the agriculture produce grown by its members,
- the purchase of agriculture implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members,
- the processing, without the aid of power, the agriculture produce of its members,
- the collective disposal of the labour of its members,
- fishing or allied activities i.e. the catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection there with for the purpose of supplying them to its members.

In the case of a co-operative-society falling within last two categories i.e. collective disposal of the labour and fishing or allied activities, deduction is available subject to the condition that the rules and bye-laws of the society restrict the voting to the following classes of its members:

1. the individuals who contribute their labour or, as the case may be, carry on the fishing or allied activities,
2. the co- operative credit societies which provide financial assistance to the society, and
3. the State government.
  - The whole of the amount of profits in the case of a co-operative society, being a primary society engaged in supplying milk raised by its member to a federal milk co-operative society or to the government or a local authority or a government company or corporation established under the central, state or provincial act. Section 80P covers primary co-operative societies which are engaged in the supply of oil seeds, fruits and vegetables. Accordingly, profits derived by a primary cooperative society engaged in supplying oil seeds, fruits or vegetables raised or grown by its members to a federal oil seeds, fruits or vegetables

co-operative society, government, local authority or a government company or a statutory corporation engaged in supplying oil seeds, fruits or vegetable to the public.

- The whole of the interest and dividend income derived by a cooperative society from its investment in any other co-operative society.
- The whole of the interest and dividend income derived by a co-operative society from the letting of godowns or warehouses for storage, or processing or facilitating the marketing of commodities.
- The whole of the interest income from securities and property income in the case of a co-operative society other than housing society or an urban consumers society or a society carrying on transport business or a society engaged in manufacturing operation with the aid of power provided gross total income of such co-operative society does not exceed ₹ 20,000.

The profit of a co-operative society, engaged in the activities other than those mentioned above either independently or in addition to all or any of the activities so specified, as does not exceed ₹ 50,000/-. In case of consumers co-operative society, the amount of deduction is ₹ 1,00,000/-.

Cottage industry, for the above purpose is required to satisfy the following criteria for availing of the benefits.

1. A cottage industry is one which is carried on small scale with a small amount of capital and a small number of workers and has a turnover which is correspondingly limited;
2. It should not be required to be registered under the factories act;
3. It should be owned and managed by the co-operative society;
4. The activities should be carried on by the members of the society and their families. For the purpose, a family would include self, spouse, parents, children and any other relative who customarily lives with such a member. Outsiders i.e., persons other than member and their families should not work for the society. In other words, the co-operative society should not engage outside hired labour.
5. A member of a co-operative society means a shareholder of a society;
6. The place of work could be an artisan shareholder's residence or it should be a common place provided by the co-operative society;

7. The cottage industry must carry on activity of manufacture, production or and it should not be engaged merely in trade, i.e., purchase and sale of the same commodity.

In the case of a weaver's society, so long weaving is done by the members of the society at their residence or at a common place provided by the society, without any outside labour, such a society will be eligible for deduction under section 80P(2)(a)(ii) even if certain payment have been made to an outside agency for dyeing, bleaching, transport arrangement, etc., provided it satisfies all other conditions necessary for availing the deduction under section 80P(2)(ii). This has been clarified as per circular No. 722, dated September 19, 1995.

Some other important points are as under:

- As per circular No. 6/2010, dated September 20, 2010, regional rural banks are not eligible for deduction under section 80P.
- As per the ratio of Totgars' co-operative sale society Ltd. v. ITO [2010] 188 taxman 282 (SC), if a society regularly earns interest on funds (not required immediately for business purposes), such interest income is taxable under section 56 under the head "income from other sources" and not eligible for deduction under section 80P.
- Interest on income tax refund – interest received on income tax refund is subject to deduction under section 80P(2)(a)(i). This is as per the decision in *Maharashtra state co-operative bank Ltd. v. CIT* [2010] 38 SOT 325 (mum.)

## **Taxation of NPOs under the provisions of Income Tax, 1961**

NPOs are generally exempt from the income tax. This has been done mainly to encourage the charities for the privileged under sections of the society in the overall interest of the country. NPOs are considered as more effective and efficient in promoting welfare of the society.

The provisions of the Income Tax Act, 1961 govern taxation of Cooperatives and NPO Sectors.

Tax exemption to NPOs is provided, on the basis of certain conditions which include the following;

1. The organization must be organized for religious or charitable purposes,

2. The organization must spend 85% of its income in any financial year on the objects of the organization,
3. Surplus income may be accumulated for specific projects for a period ranging from 1 to 5 years,
4. The funds of the organization must be deposited as specified in section 11(5) of the Income Tax Act,
5. No part of the income or property of the organization may be used or applied directly or indirectly for the benefit of the founder, trustee, relative of the founder or trustee or a person who has contributed in excess of ₹ 50,000 to the organization in a financial year,
6. The organization must file its annual income tax return timely and the income must be applied or accumulated in India. However, trust income may be applied outside India to promote international causes in which India has an interest, without being subject to income tax.

### ***Tax Rates for NPOs***

Rate applicable to Association of Person (AOP) is also applicable for trusts, societies, NPOs etc.

For the companies formed u/s 25 rate of tax is flat @ 30% on their income.

The relevant sections for the purposes of tax exemption to the NPOs are Section 11, 12, 12A and 13. The NPO for tax exemption should be one established in accordance with the provisions of law and its objects should fall within the definition of the term "charitable purpose".

Section 2 (15) provides as to what acts are included under Charitable purpose. It includes relief to the poor, education, medical relief, preservation of environment (including watersheds, forest and wildlife) and preservation of monuments or places or objects of artistic or historic interest and the advancement of any other object of general public utility.

Finance Act, 2008 limited the definition of "charitable purpose" by stating that if the "advancement of any other object of general public utility" involves undertaking any trade, commerce, or business activities, or rendering any related service for a fee or any other condition (irrespective of use, application, or retention of income arising from such activities), it will not be considered a "charitable purpose."

Finance Act 2009 added the "preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest" to the list of charitable purposes.

The Finance Act 2010, retrospectively from April 1, 2009, provided some relief by exempting the aggregate value of receipts from such activities up to ten lakhs rupees which has been further increased to twenty five lakhs rupees by the Finance Act, 2012.

***Advancement of any other object of general public utility***

The above provision has been amended by the Finance Act, 2008 effective from the assessment year 2009-10, "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 of business, or any activity of rendering any service in relation to any trade, commerce of business for a cess or fee or any other consideration. This restriction is, however, applicable, only if the total receipts from 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 exceed ₹ 25 lakhs (for assessment year 2012-13 onwards) in the previous year.

***Current Scenario after issue of Circular No. 11/2008, date December 19, 2008***

The above provision as amended by the Finance Act, 2008, will not apply in respect of the first four limbs of section 2(15), i.e., relief of the poor, education, medical relief or preservation of environment, etc. Consequently, where the purpose of a trust or institution is relief of the poor, education, medical relief or preservation of environment etc., it will constitute 'charitable purpose' even if it incidentally involves the carrying on of commercial activities. The amendment made by the Finance Act, 2008 will apply only to entities whose purpose is, "advancement of any other object of general public utility", i.e., the fifth limb of the definition of 'charitable purpose' contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

Where industry or trade associations claim both to be charitable institution as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) (inserted by the finance act, 2008) owing to the principal of mutuality. However, if such organization have dealings with non-members, their claim to be charitable organization would

now be governed by the additional conditions stipulated by the Finance Act, 2008 in the proviso to section 2(15).

### ***Registration with the Commissioner of Income Tax***

The trust must get itself registered with the Commissioner of Income Tax for getting the benefits of income tax exemption. Application for registration is filed in from No.10A with the Commissioner of Income Tax. Registration will be granted by the Commissioner from the previous year in which the application is made.

The Commissioner, if he so desires, may call for document and information and also may hold enquiries regarding the genuineness of the trust or institution. After he is satisfied about the charitable or religious nature of the object and genuineness of the activity of the trust or institution, he will pass an order granting registration and if he is not so satisfied, he will pass an order refusing registration, subject to the condition that an opportunity of being heard shall be provided to the applicant before an order of refusal to grant of registration is passed and reasons for such refusal shall be mentioned in the order. The order granting or refusing registration has to be passed within six months from the end of the month in which the application for registration is received by the commissioner and a copy of such order shall be sent to the applicant. The grant of registration shall be one of the conditions for the grant of income tax exemption.

### ***Other conditions for exemption from income tax***

The compliance of the following main conditions is essential for claiming exemption under section 11.

- The property from which income is derived should be held under a trust or other legal obligation.
- The property should be held for charitable or religious purposes.

In the case of a charitable trust created on or after April 1, 1962, the future conditions are.

- The trust should not be created for the benefit of any particular religious community or caste,
- No part of the income should ensure direct or indirect benefit to the settler or other specified persons.
- The property should be held wholly for charitable purposes.

These conditions also apply to religious trusts created on or after April 1, 1962.

The exemption is confined to only such portion of the trust's income which is applied to charitable or religious purposes or is accumulated for applying to such purposes within the limits of accumulation permitted under section 11(1) and (2).

The exemption is restricted to such portion of the income as is applied to charitable or religious purposes in India except in the cases covered by section 11(1)(C).

Where trust property comprises a business undertaking, the income shown in the books of account should not be less than the income determined by the Assessing Officer according to the provisions of the Act. However, the exemption from tax will not be available to any religious or charitable trust or institution in respect of business profit, unless. –

1. The business is carried on by the trust wholly for public religious purpose and the business consists of printing and publication of books or publication of books or is of a kind notified by the government; or
2. The business is carried on by the institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution;

and the separate books of account are maintained by the trust/institution of such business. From the assessment year 1992-93, trusts or institution can carry out business activities if business activities are incidental to the attainment of its objectives and separate books of account are maintained. In other words, irrespective of whether any business is carried on by such a trust or institution or the business undertaking itself is held in trust, in either case, the trust or institution is charged to tax on such profits and gains at the rates of tax applicable in the case of individuals, association of persons, body of individuals, etc., if the above condition are not satisfied.

### ***Some other relevant provisions***

If the Commissioner of Income Tax is satisfied that the activities of any trust or institution are not genuine (or are not carried out in accordance with the objects of the trust or institution), he shall pass an order cancelling the registration granted under section 12AA or 12A.

The accounts of the trust should be audited and (Form no. 10B) for such accounting year in which its income (without giving effect to the provisions of section 11 and 12) exceeds the exemption limit.

The funds of the trust should be invested or deposited in any one or more of the modes or forms mentioned in section 11(5).

***Sec.11 (5)-Forms or modes of investment***

A uniform pattern of investment is laid down, for all categories of funds belonging to charitable and religious trusts or institutions. The same pattern of investment will apply in relation to accumulation of income in excess of 15 per cent. The uniform or modes for investing funds of charitable and religious trusts and institutions are given below.

- a. investment in government saving certificates,
- b. deposit in any post office saving bank account,
- c. deposit in any account with any scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank),
- d. investment in any Central or State government securities,
- e. investment in units of the Unit Trust of India,
- f. investment in debentures of any corporate body, the principal whereof and the interest whereon are guaranteed by the Central or a State government. As decided in *DIT v. Shree Visheshwar Nath Memorial Public Charitable Trust*<sup>7</sup>, "debenture" includes bonds,
- g. Investment or deposit in any public sector company.
- h. As per the proviso of clause (vii) of section 11(5), where an investment is made in the shares of any public sector company and such public sector company ceases to be a public sector company, the investment so made for a period of 3 years from the date such company ceases to be a public sector company and in the case of any other investment or deposit, it shall be deemed to be an investment made for the period up to the date on which such investment or deposit becomes repayable by such company,
- i. deposits with or investment in any bonds issued by any financial corporation engaged in providing long-term funds for industrial development in India, if the corporation is eligible for deduction under section 36(1)(viii),

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<sup>7</sup> (2010) 194 Taxman 280 (Delhi).

- j. deposits with or investment in any bonds issued by any public company carrying on the business of providing long-term finance for construction or purchase of house in India for residential purposes, if the company is eligible for deduction under section 36(1)(viii),
- k. deposits with Industrial Development Bank of India,
- l. immovable property,
- m. any other prescribed form or mode of investment , and
- n. deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India<sup>8</sup>.

Other prescribed forms/modes of investments for the point no. l.

Rule 17C of the Income Tax Rules, 1962 specifies the following other modes:

- (1) Investments in units issued under any scheme of mutual fund referred to in section 10(23D);
- (2) Any transfer of deposits to Public Account of India;
- (3) Deposits made with an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both;
- (4) Investment by way of acquiring equity shares of a 'depository';
- (5) Investment made by a recognized stock exchange in the equity share capital of a company -
  - (a) which is engaged in dealing with securities or mainly associated with the securities market;
  - (b) whose main object is to acquire the membership of another recognized stock exchange for the sole purpose of facilitating the members of the investor to trade on the said stock exchange through the investee in accordance with the directions or guidelines issued under the Securities and

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<sup>8</sup> For this purpose "long term finance " means any loan or advance where the terms under which money is loaned or advanced provide for repayment along with interest thereof during a period of not less than 5 years.

"Urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyover or urban transport.

Exchange Board of India Act, 1992 by the Securities and Exchange Board of India established under section 3 of that Act; and

- (c) in which at least fifty-one per cent of equity shares are held by the investor and the balance equity shares are held by members of such investor;
- (6) Investment made by way of acquiring equity shares of an incubatee by an incubator.
- (7) Investment by way of acquiring shares of National Skill Development Corporation.

### ***Sec. 11(1)-Application of Income***

In order to claim tax exemption, a charitable trust or institution will have to apply at least 85 per cent of the income to charitable or religious purposes. Voluntary contributions or donations (not being contributions made with a specific direction that they will form a part of the corpus of the trust/institution) will be deemed to be a part of the income derived from property held under trust. If the income applied to charitable or religious purposes, during the previous year, falls short of 85 per cent of the income derived during the year, either because

- (a) the income has not been received in the relevant previous year. or
- (b) because of any other reason, the charitable trust or institution has been given an option to spend such income for charitable or religious purposes in the following manner.

In case of (a) either during the previous year in which the income is so received or during the previous year immediately following such year ; and in the case of (b) during the previous year immediately following the previous year in which the income was derived.

For availing of the benefit of extended time beyond the relevant previous year, the charitable trust or institution, in either case, has to exercise the option in writing under clause (2) of explanation to section 11(1) within the time allowed, under section 139 for furnishing the return of income.

Income applied to such purposes during the extended time will be deemed to have been applied to such purposes during the previous year in which it was derived.

Where, however, any income in respect of which an option is exercised under clause (2) of explanation to section 11(1) is not applied for charitable

or religious purposes in India during the extended time, such income is liable to be taxed as the income.

***Sec. 11(2)-Accumulation of Income***

Where 85 per cent of the income is not applied to charitable or religious purposes in the aforesaid manner, the charitable trust or institution may accumulate or set apart either the whole or part of its income for future application for such purposes in India. Such income so accumulated or set apart will not be included in the total income of the trust or institution in the year of receipt of income, provided such trust or institution has specified by means of a notice to the Assessing Officer, in Form No. 10, the purpose and period (which in no case can exceed 5 years) for which the income is accumulated or set apart. Further, the money so set apart or accumulated should be invested in any one or more of the modes / forms specified in Section 11(5).

Following is the table which explains the limits of the tax payable to Income Tax Department under section 11.

| <i>Section</i> | <i>Nature of income</i>   | <i>Extent to which exemption allowed</i>   |
|----------------|---|--|
| 11(1)(a)       | Income derived from property held under trust wholly for charitable or religious purposes   | To the extent income applied to such charitable or religious purposes in India.<br><br>Whereas accumulated or set apart for such application, to the extent of 15% of the income from such property. |
| 11(1)(c)       | Income derived from property held under trust for a charitable purpose, which tends to promote international welfare in which India is interested | To the extent income is applied to such charitable or religious purposes outside India.<br><br>Exemption is available only if the Board has directed such exemption.                                 |
| 11(1)(d)       | Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution. | 100% exemption   |

In computing the 15% of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in Section 12 shall be deemed to be part of the income.

**Exemptions not allowed u/s 11**

| <i>Section</i> | <i>Nature &amp; extent of income not exempt under Section 11</i>  |
|----------------|---|
| 13(1)(a)       | Income of private religious trust not used for public benefit   |
| 13(1)(b)       | Income of charitable trust created for benefit for particular religious community.  |
| 13(1)(c)       | Income/ property of charitable or religious trust applied for direct or indirect benefit of person referred in 13(3).   |
| 13(1)(d)       | Any income, is taxable if;<br>Any funds are invested other than in Section 11(5);<br>Any funds invested earlier than 1983 remain invested thereafter;<br>Shares and company are held after 1983.  |
| 11(4A)         | Income from business which is not incidental to the attainment of the objectives of the trust, or in respect of which separate books of accounts have not been maintained.  |
| 12(2)          | Value of medical/ education services provided to specified persons by trust running hospital and educational institution shall be income of trust and will be chargeable in the year in which services are provided and chargeable to tax, despite section 11(1). |

***Condonation<sup>9</sup> of delay in filing the notice under Section 11(2)***

Delay in filing the notice is condonable by Commissioners. CBDT Circular No. 273, dated 3-6-1980 has authorized Commissioners to admit applications under Section 11(2), read with rule 17, from persons deriving income from property held under the trust wholly for charitable or religious purposes for accumulation of such income to be applied for such purposes stipulated subject to the condition inter alia that the failure to give notice to the Income-tax Officer under section 11(2) and investment of the money in the prescribed securities was due to only oversight.

In Kerala Rural Employment & Welfare Society v. Asstt. DIT [2009] 184 Taxman 93 (Ker.), where according to the petitioner, there was delay by

<sup>9</sup> <http://www.incometaxindiapr.gov.in>.

Chartered Accountant in finalizing the accounts and it was for that reason that the notice in Form No. 10 for accumulation was not filed within the time indicated in rule 17 and the Commissioner rejected the application for condonation of delay in giving Form 10 under rule 17, the authority was directed to pass an order in the light of the CBDT circular prescribing conditions for admitting applications by the Commissioner under section 11(2) read with rule 17.

Intimation required under section 11(2), read with rule 17, has to be furnished before assessing authority completes concerned assessment because such requirement is mandatory CIT v. Nagpur Hotel Owners' Association [2001] 114 Taxman 255/247 ITR 201 (SC) [See also CIT v. Mayur Foundation [2005] 274 ITR 562 (Guj.)/CIT v. Simla Chandigarh Diocese Society [2009] 318 ITR 96 (P&H)]. Rule 17 is unambiguously specific insofar as it mandates that the notice shall be delivered before the expiry of the time allowed under section 139(1) for furnishing the return of income. By no stretch of imagination can the extended period which is given under section 139(4) be made available for giving the notice for accumulation of income by charitable trust or institution beyond the period mentioned in section 139(1). - Kerala Rural Employment & Welfare Society v. Asstt. DIT [2009] 184 Taxman 93 (Ker.). Plurality of purposes for accumulation of income is not prohibited - Director of Income-Tax v. Mitsui & Co. Environmental Trust [2007] 211 CTR (Delhi) 352. So long as one or more of the purposes specified in Form No. 10 finds a place in the objects for which the assessee-society has been incorporated, and those purposes are charitable, exemption benefit under section 11 cannot be denied - Director of Income-tax (Exemption) v. Daulat Ram Education Society [2005] 278 ITR 260 (Delhi). Where assessee had mentioned that accumulation of income was towards all the three objects for which it was created, exemption cannot be denied merely because assessee had not specifically mentioned the purposes - Bharat Kalyan Pratisthan v. Director of Income-tax [2007] 160 Taxman 216 (Delhi). Where assessee had indicated that accumulation of income was for the "on-going projects" (without specified them), and those objects were found to be charitable, benefit of exemption cannot be denied - Director of Income-tax (Exemption) v. Mamta Health Institute for Mother & Children [2007] 162 Taxman 235 (Delhi).

An assessee can give notice in writing in Form No. 10 for more than one year in order to claim accumulation of income under section 11(2), and claim of assessee cannot be denied merely on ground that in subsequent year or years no further notice is given by assessee - Cotton Textiles Export Promotion Council v. ITO [2008] 20 SOT 187 (Mum. - Trib.).

The following should also be noted –

1. if in any year income accumulated for a specified purpose or purposes of the trust is applied to purposes other than charitable or religious purpose or ceases to be accumulated or set apart for application to such purposes, it will become chargeable to tax as the income of that year.
2. if in any year the accumulations cease to remain invested in securities as specified above, then also the income so accumulated will become chargeable to tax as the income of that year.
3. if the accumulations are not utilized for the specified purposes during the period of accumulation or in the year immediately following the expiry of that period, then the accumulations, to the extent they are not so utilized, will become chargeable to tax as income of the previous year immediately following the expiry of that period.
4. sometimes failure to apply the income so accumulated or set apart in the specified manner may arise due to circumstances beyond the control of the trustees. In such a case, the Assessing Officer may, on the receipt of an application from the person in receipt of the income, allow such income to be applied for such other charitable or religious purposes in India as are in conformity with the objects of the trust /institution.
5. any amount paid or credited out of accumulated income to any trust or institution registered under section 12AA or to any fund or institution or trust or any university or order educational institution or any hospital or other medical institution either during the period of accumulation or thereafter, shall not be treated as application of income for charitable or religious purposes. Thus, payment to other trust and institution out of income from property held under trust in the year of receipt will continue to be treated as application of income. However, any such payment out of the accumulated income shall not be treated as application of income and will be taxed in the year in which such payment /credit is made out of accumulated income.

### ***Section 13 - Forfeiture of exemption***

The following incomes of charitable/religious trusts/institutions do not qualify for exemption under section 13:

1. Income for private religious purposes – any part of income from a property held under a trust for private religious purposes which does

not ensure for the benefit of the public is not eligible for exemption under section 11 or 12.

2. Income for the benefit of particular religious community – entire income of a charitable trust/institution (established on or after April 1, 1962) created for the benefit of any particular religious community or caste is not eligible for exemption under section 11 or 12. A trust or institution created or established for the benefit of scheduled castes, backward classes, scheduled tribes or woman and children shall not be deemed to be a trust or institution created or established for the benefit of a religious community or caste for this purpose.
3. Income for the benefit of interested persons – If religious/charitable trust/institution is created or established after March 31, 1962 and any part of its income ensures directly or indirectly under the rules governing the trust, for the benefit of any persons specified in section 13(3), then the entire income of such trust is not eligible for exemption under section 11 or 12.

Entire income of a trust/institution created /established after March 31, 1962 is also not eligible for exemption under section 11 or 12 if the income /property is used /applied, during the relevant year, for the direct/indirect benefit of the author of the trust and other persons mentioned in section 13(3). This provision is also applicable in the case of a trust /institution created /established prior to April 1, 1962 but in such case exemption is not forfeited if such use of the trust income /property is in compliance with a mandatory provision in the terms of the trust or mandatory rule governing the institution.

## Interested Person

For the purpose of section 13, the following are interested persons:

- a. the author of the trust or the founder of the institution;
- b. any person who had made a total contribution (up to the end of the relevant previous year) of an amount exceeding ₹ 50,000 (substantial contributor);
- c. any member of the HUF (or any relative of such member ) where such author or founder or substantial contributor is a HUF;
- d. any trustee of the trust or manager (by whatever name called) of the institution;

- e. any relative of such author, founder, substantial contributor, member, trustee or manager;
- f. any concern in which any of persons referred to above has a substantial interest.

## Relative

A "relative" in relation to an individual means:

- a. spouse of the individual;
- b. brother or sister of the individual;
- c. brother or sister of the spouse of the individual;
- d. any lineal ascendant or descendent of the individual;
- e. any lineal ascendant or descendent of the spouse of the individual;
- f. spouse of a person referred to in (b), (c), (d) or (e) above;
- g. any lineal ascendant or descendent of a brother or sister or either the individual or of the spouse of the individual.

## Meaning of Substantial Interest

For the aforesaid provisions, a person will be deemed to have substantial interest in a company if he (or along with "interested persons" mentioned above) beneficially holds at least 20 per cent equity share capital of the company at any time during the previous year. In the case of a concern other than a company, a person will be deemed to have substantial interest, if he (or along with "interested persons" mentioned above) is entitled to at least 20 per cent of the profits of such concern at any time during the previous year.

## Benefit Deemed to be Applied on An Interested Person

The income or the property of the trust or institution shall be deemed to have been used or applied in a manner which results directly or indirectly in conferring any benefit, amenity or perquisite (whether convertible into money or not) on any interested person, in the following scenarios;

1. Where any part of the income or property of the trust or institution is or continues to be lent to any interested person for any period during the previous year without adequate security or adequate interest or both.

2. Where any land, building or other property of the trust/ institution is (or continues to be) made available for the use of any interested person for any period during the previous year without charging adequate rent or other compensation.
3. Where any amount is paid by way of salary, allowance or otherwise during the previous year to any interested person out of the resources of the trust/institution for services rendered by that person to such trust/institution and the amount so paid is more than what may be reasonably paid for similar services.
4. Where the services of the trust or institution are made available to any interested person during the previous year without adequate remuneration or compensation.
5. Where any share, security or other property is purchased by or on behalf of the trust/ institution from any interested person during the previous year for more than adequate consideration.
6. Where any share, security or other property is sold by or on behalf of the trust/ institution to any interested person during the previous year for less than adequate consideration.
7. Where any income or property of the trust/institution is diverted during the previous year in favour of any interested person. Where, however, the aggregate of income or the value of the property so diverted does not exceed ₹ 1,000, then this provision not applicable.
8. Where any fund of the trust/ institution are (or continues to remain) invested for any period during the previous year in any concern in which any interested person has a substantial interest. Where, however, the aggregate of the funds of the trust/institution invested in a concern in which any interested person has a substantial interest does not exceed 5 per cent of the capital of that concern, exemption under section 11 will not be denied in relation to the application of any income other than the income arising to the trust or institution from such investment.

### **Fund not invested in Section 11(5) Securities/ Deposits**

Income of a trust/institution is not eligible for exemption under section 11 or 12 if its funds are invested/ deposited otherwise than in the forms specified in section 11(5). In the regard the following should also be noted:

1. The exemption under section 11(1)(a) is available only if at least 85 per cent of the income is applied for charitable/religious purposes in

India during the year and the remaining amount is invested in the forms/modes specified under section 11(5). Thus, both the requirements will have to be fulfilled before the trust can claim and avail of the exemption under section 11(1)(a).

The following example has been given in circular No. 335, dated April 13, 1982 to elaborate the above point. A trust derives income from property held for charitable purposes to the extent of ₹ 40,000 in a year. Under section 11(1)(a) it has to spend at least ₹ 30,000 on the charitable purposes. The balance of ₹ 10,000 will have to be invested in the forms/modes prescribed under section 11(5). It is only then that the entire income of the trust will get exemption.

2. Any charitable or religious trust or institution will forfeit exemption from tax if any funds of the trust or institution are invested or deposited, after February 28, 1983, otherwise than in any one or more of the modes specified in section 11(5). Such trust and institution will also forfeit exemption from tax if any part of their funds invested before March 1, 1983 otherwise than in any or more of the forms or modes specified in section 11(5), continue to remain so invested or deposited after November 30, 1983. Trust or institution which continue to hold any shares in a company [other than shares in a public sector company or shares which are prescribed as mode of investment under section 11(5)(xii) after the said date will also forfeit exemption from income tax.

### **Exemptions not forfeited even if funds are invested otherwise than in the Modes Specified In Section 11(5)**

1. The exemption is not denied in relation to the assets held by the trust or institution where such assets form a part of the corpus of the trust or institution as on June 1, 1973.
2. Similarly, exemption is not denied in relation to any accretion to the assets, being shares of a company forming part of the corpus of the trust or institution as on June 1, 1973, where such accretion arises by way of allotment of bonus shares.
3. Exemption is not forfeited in relation to debentures/bonds acquired by the trust or institution before March 1, 1983. Where debentures of an Indian company are acquired by the trust or institution after February 28, 1983 but before July 25, 1991, the exemption from tax under section 11 will be denied only in respect of interest on such debentures. If however, such debentures are not disinvested by

March 31, 1992, the trust or institution will lose exemption under section 11.

4. Exemption is not forfeited in relation to any funds representing the profit and gain of a business, if the trust/institution maintains separate books of account in respect of such business.

Educational and medical facilities to specified persons [sec. 12(2) and 13(6)] – Section 12(2) and 13(6) provide as follows-

1. Income of a charitable or religious trust will not be exempt if any part of such income or any property of the trust is used or applied directly or indirectly for the benefit of any person such as the author of the trust, trustee or any relative of such persons or any concerns in which such person have a substantial interest referred to as interested person in above paras. Sub-section (6) of section 13 provides that a charitable or religious trust running an educational institution or a medical institution or a hospital shall not be denied the benefit of exemption under section 11 or section 12, in relation to any income by reason only that such trust has provided educational or medical facilities to interested persons.
2. Sub-section (2) of section 12 provides that the value of any medical or educational services made available by any charitable or religious trust running a hospital or medical institution or an educational institution to any interested person shall be deemed to be the income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income tax notwithstanding the provision of section 11(1).

### **Section-13(7)-Anonymous Donation**

As per Section 13 (7) any anonymous donation will not be eligible for deduction under section 11 and 12.

Section 115BBC(3) defines "*anonymous donation*" as under:

1. It is a voluntary contribution referred to in section 2(24)(iia).
2. The person receiving such contribution does not maintain a record of-
  - a. the identity indicating the name and address of the person making such contribution ; and
  - b. such other record as may be prescribed.

Section 115BBC(1) provides that the Anonymous donations would be taxable at the rate of 30 per cent, to the extent such donations exceeds ₹ 1,00,000 or 5 per cent of total donation received by trust, whichever is higher.

### **Institution Affected by the Provision of Section 115BBC (1)**

The following shall be affected by the above provisions

- a. any trust of institution referred to in section 11;
- b. any university or other educational institution referred to in section 10(23C)(iiiad) and (vi);
- c. any hospital or other institution referred to in section 10(23C)(iii ae) and (via);
- d. any fund or institution referred to in section 10(23C)(vi); and
- e. any trust or institution referred to in section 10(23C)(v).

### **Section 115BBC (2) - Donation not Affected by the Above Provision**

The following anonymous donations received shall not be covered by the provision of section 115BBC;

- (i) donations received by any trust or institution created or established wholly for religious purposes; and
- (ii) donations received by any trust or institution created or established for both religious as well as charitable purposes.

However, donation mentioned in point (ii) above does not include any anonymous donation made with a specific direction that such donation is for any university or other educational institution or any hospital or other medical institution run by such trust or institution.

### **Some Situations for Anonymous Donations-Effective For AY 2012-13 and AY 2013-14**

| <i>Situations of anonymous donations</i>                     | <i>Tax treatment</i>  |
|--|---|
| Situation 1 – Wholly religious entities                      | Section 115BBC is not applicable  |
| Situation 2– Partly religious and partly charitable entities | If anonymous donation is made to an educational or medical institution run by such entity, such anonymous |

## Taxation of Cooperatives and NPO Sectors

|  |   |
|--|---|
|  | donation is taxable at the rate of 30 per cent. Any other anonymous donation is not subject to tax under section 115BBC.  |
| Situation 3- Wholly charitable entities  | All anonymous donations are taxed at the rate of 30 per cent under section 115BBC.  |
| Situation 4- If aggregate anonymous donation is ₹ 1 lakh or less.  | Section 115BBC will not be applicable.  |
| Situation 5- If aggregate anonymous donation is more than ₹ 1 lakh but it is not more than 5 per cent of the total donations received by the assessee. | Section 115BBC will not be applicable.  |
| Situation 6- If aggregate amount of anonymous donation is more than ₹ 1 lakh or 5 per cent of the total donations received, whichever is higher.       | The excess amount shall be subject to tax at the rate of 30 per cent under section 115BBC. However, it shall be taxable only in the situation 2 and situation 3 as mentioned above. |

### Commercial Receipts- Threshold under Section 13(8)- ₹ 25 Lakhs

Where the activity of any trust or institution is of the nature of advancement of any other object of general public utility, it involves carrying on of any activity in the nature of trade, commerce or business and the aggregate value of receipts from the commercial activities exceeds ₹ 25 lakh in the previous year, then the purpose of such institution shall not be considered as charitable. Such trust or institution will not be entitled to get benefit of exemption with effect from the assessment year 2009-10 under section 11 and 12 [ and also section 10(23C)] in respect of its income for that previous year for which such receipts exceed ₹ 25 lakhs.

## **Tax on Non Exempt Public Charitable/Religious Trust**

In the following cases, where income of a charitable/religious trust which is not exempt under section 11 or 12 is chargeable to tax as if it is income of an association of persons:

- a. income from property held under trust wholly for the charitable or religious purposes;
- b. voluntary contribution without any direction that they shall form a part of the corpus of trust; or
- c. income of trusts or institutions being profits and gains of business which is incidental to the attainment of the objectives of trust and separate books of account are maintained.

## **Levy of Tax at Maximum Marginal Rate in case of Public Charitable And Religious Trust Which Forfeit Tax Exemption**

Charitable or religious trusts, which may otherwise be eligible for tax exemption, are liable to forfeit the exemption in the following circumstances and charged to tax at the maximum marginal rate of 30 per cent for the assessment year 2012-13 and 2013-014:

1. where the trust is created after March 31, 1962, any part of the income of the trust inures, under the terms of the trust deed, directly or indirectly, for the benefit of specified categories of persons such as, the author of the trust, trustee or manager of the trust, substantial contributor to the trust and any relative of such author, trustee, etc.
2. any part of the income or any property of the trust (whenever created ) is used or applied during the relevant year, directly or indirectly, for the benefit of specified categories of persons.
3. the trust funds are invested in contravention of the investment provisions.

### **Important points in brief**

- The Income Tax Act, 1961, which is a national all-India Act, governs tax exemption of not-for-profit entities. Organizations may qualify for tax-exempt status if certain conditions are met.

## Taxation of Cooperatives and NPO Sectors

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- The organization must be organized for religious or charitable purposes;
- The organization must spend 85% of its income in any financial year (April 1st to March 31st) on the objects of the organization. The organization has until 12 months following the end of the financial year to comply with this requirement. Surplus income may be accumulated for specific projects for a period ranging from 1 to 5 years;
- The funds of the organization must be deposited as specified in section 11(5) of the Income Tax Act;
- No part of the income or property of the organization may be used or applied directly or indirectly for the benefit of the founder, trustee, relatives of the founder or trustee or a person who has contributed in excess of ₹ 50,000 to the organization in a financial year;
- The organization must timely file its annual income return;
- The organization's income must be applied or accumulated in India. However, trust income may be applied outside India to promote international causes in which India has an interest, without being subject to income tax; and
- The organization must keep a basic record (name, address and telephone number) of all donors. According to section 115BBC, introduced with the Finance Act, 2006, all anonymous donations to charitable organizations are taxable at the maximum marginal rate of 30%. Finance Act, 2009, however, carves out the following exception: anonymous donations aggregating up to 5% of the total income of the organization or a sum of ₹ 100,000, whichever is higher, will not be taxed. Additionally, religious organizations (temples, churches, mosques) are exempt from the provisions of this section.
- Public charitable trusts must benefit a large class of beneficiaries and must be for the public benefit. Moreover, trustees of public charitable trusts may not engage in self-dealing.
- The Societies Registration Act, 1860 does not prohibit the inurement of any earnings of the society to any private shareholder or individual.
- The Section 25 of the Indian Companies Act, 1956 specifically provides that no profits, if any, or other income may be distributed by way of dividends to its members.

- The Income Tax Act 1961 specifically provides that an NPO entity will lose tax exempt status if the author, founder, or any trustee or his/her relative derives any personal benefit.

### **Activities-Economic, Investment and Political**

There are no restrictions on an Indian NPO's incidental business/commercial/economic activities provided the NPO is established for and primarily runs programs for relief of poverty or distress, education, or medical relief. However, profits must be applied fully towards charitable objects. If this is not done, then the NPO will lose its income tax exemption and its income will be liable to tax at the maximum marginal rate (30%). Further the NPO must maintain separate books of account for the business/commercial/economic activities as per the provisions of Income Tax Act, 1961.

State and national laws limit the types of investments NPOs may make. For example, Indian NPOs may not invest in shares of public or private limited companies. Furthermore, not-for-profit organizations registered in India may not invest abroad.

According to local experts, NPOs in India may not engage in political campaign activities or legislative activities. However, they may lobby for non-political causes provided that such activity promotes the general public utility and is incidental to the attainment of such NPO's objects.

As per Section 20 of the Societies Registration Act, 1860, Societies may have as their primary objective the diffusion of political education which was also decided in their favour in the case of *Laxman Balwant Bhopatkar v. Charity Commissioner* [1963] 2 SCR 625; AIR 1962 SC 1589.

Capital contributions or donations to an endowment should not be included when computing the total income of the organization.

### **Disqualification from Exemption**

The following groups are ineligible for tax exemption: all private religious trusts; and charitable trusts or organizations created after April 1, 1962; and charitable trusts established for the benefit of any particular religious community or caste. Note, however, that a trust or organization established for the benefit of "Scheduled Castes, backward classes, Scheduled Tribes or women and children" is an exception; such a trust or organization is not disqualified, and its income is exempt from taxation.

## **Customs Duty**

NPOs involved in relief work and in the distribution of relief supplies to the needy are 100 percent exempt from customs duty on the import of items such as food, medicine, clothing and blankets. Moreover, other exemptions may be available, such as an exemption from customs duty for scientific/technical equipment and components intended for research institutes.

## **Wealth Tax**

As per Section 3(1) of the Wealth Tax Act, 1957, only Individuals, Hindu Undivided Families and Companies are liable to wealth tax. Thus, no wealth tax is charged in the case of Cooperatives and also to a large extent in NPO Sectors.

## **Service Tax**

In the system of newly introduced service tax, all services, other than services specified in negative list and exemption notification shall be covered.

## **Sales Tax/VAT**

Sales tax/VAT is levied on the sales made by NGOs as per the respective sales tax/VAT provisions of the respective state.

## **Reporting Foreign Contributions**

Under the provisions of Foreign Contribution (Regulation) Act, 2010 and Foreign Contribution (Regulation) Rules, 2011, an NPO in India (e.g., public charitable trusts, societies and section 25 companies) wishing to accept foreign contributions must

- (a) register with the Central Government;
- (b) agree to accept contributions through designated banks; and
- (c) maintain separate books of accounts with regard to all receipts and disbursements of funds.

Furthermore, not-for-profit entities must report to the Central Government all foreign contributions within 30 days of the receipt of such contribution, and must file annual reports with the Home Ministry. The entity must report the amount of the foreign contribution, its source, the manner in which it was received, the purpose for which it was intended, and the manner in which it

was used. Foreign contributions include currency, securities, and articles. Funds collected by an Indian citizen in a foreign country on behalf of an NPO registered in India are considered foreign contributions. Moreover, funds received in India, in Indian currency, if from a foreign source, are considered foreign contributions.

Guidelines require that an organization allowed to receive funds from a foreign source may provide funds from its account to another organization, only if the other organization also has clearance from the Home Ministry to receive funds from a foreign source.

Under the Foreign Contributions (Regulation) Act, foreign contributions cannot be received by political parties or not-for-profit organizations involved in political activities.

## Chapter 3

# Tax Benefits to NPO Sector: Present Status in Few Selected Countries

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An NPO is treated in most of the countries as an organisation that uses its income/ revenues to achieve its goals and generally do not use them in distributing them as profit or dividends.

While NPOs are permitted to generate surplus revenues, they must be retained by the organization for its self-preservation, expansion, or plans. NPOs have controlling members or boards. Many have paid staffs including management, while others employ unpaid volunteers and even executives who work with or without compensation (occasionally nominal). Where there is a token fee, in general, it is used to meet legal requirements for establishing a contract between the executive and the organization<sup>10</sup>.

The extent to which an NPO can generate surplus revenues may be constrained or use of surplus revenues may be restricted. In many countries, nonprofits may apply for tax exempt status, so that the organization itself may be exempt from income tax and other taxes. The taxation policy and procedure for the creation of non-profit organisations of some of the countries have been discussed hereinafter to give a basic understanding in this regard:

### Australia

In Australia, non-profit organisations can be categorized variously: Unincorporated Associations, Co-operative Societies, Incorporated Associations, Not-for-profit Companies, and Trusts. A Non-profit organisation in Australia can have a number of legal formats depending on the needs and activities of the organisation in question. As a legal entity, the organisation may be a co-operative society, a company limited by guarantee, an incorporated association or society by the Associations Incorporation Act 1985 or an incorporated association or council by the Commonwealth Aboriginal Councils and Associations Act 1976.

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<sup>10</sup> <http://en.wikipedia.org>.

## Canada

Canada allows non-profit organisations to be incorporated or unincorporated. The non-profit organisations may incorporate either federally (under Part II of the Canada Corporations Act) or provincially, by widely varying provincial legislation. Many of the governing Acts for Canadian nonprofits were enacted in early 1900s, meaning that nonprofit legislation has not kept pace with legislations of current era which govern corporations working for profit, particularly in context of corporate governance. Federally and in some provinces (such as Ontario), incorporation is by way of Letters Patent, and any change to the Letters Patent (even a simple name change) requires formal approval by the appropriate government, as do changes in bye-laws. Other provinces (such as Alberta) permit incorporation *as of right*, by the filing of Articles of Incorporation or Articles of Association.

During 2009, the federal government enacted new legislation repealing the Canada Corporations Act, Part II - the Canada Not for Profit Corporations Act. It allows for incorporation *as of right*, by Articles of Incorporation; does away with the ultra vires doctrine for nonprofits; establishes them as legal persons; and substantially updates the governance provisions for nonprofits. Ontario also overhauled its legislation, adopting the Ontario Not-for-Profit Corporations Act during 2010.

Canada also permits a variety of charities (including public and private foundations). Charitable status is granted by the Canada Revenue Agency (CRA) upon application by a nonprofit; charities are allowed to issue income tax receipts to donors, must spend a certain percentage of their assets (including cash, investments and fixed assets) and file annual reports in order to maintain their charitable status. In determining whether an organization can become a charity, CRA applies a common law test to its stated objects and activities. These must be:

- The relief of poverty;
- The advancement of education;
- The advancement of religion; or
- Certain other purposes that benefit the community in a way the courts have said are charitable.

Charities are not permitted to engage in political activity; doing so may result in the revocation of charitable status.

## Finland

In Finland, "rekisteröity yhdistys", given the abbreviation ry, denotes a registered association. This is done at a cost of 100 Euro. The association is required by law to keep a list of members. It must also hold an AGM and at least 3 members are required to initiate it, a secretary, chairperson and treasurer being the usual format.

## Hong Kong

The Hong Kong Company Registry provides a memorandum of procedure for applying to Registrar of Companies for a Licence under Section 21 of the Companies Ordinance for a limited company for the purpose of promoting commerce, art, science, religion, charity, or any other useful object.

## Ireland

The Irish Nonprofits Database was created by Irish Nonprofits Knowledge Exchange (INKEx) to act as a repository for regulatory and voluntarily disclosed information about Irish public benefit nonprofits. The database lists more than 10,000 not for profit organisations in Ireland. INKEx is currently looking for Government funding to continue to provide the service and maintain the accuracy of the database.

## Japan

In Japan, an NPO is any citizen's group that serves the public interest and does not produce a profit for its members. NPOs are given corporate status to assist them in conducting business transactions. As of February 2011, there were 41,600 NPOs in Japan. Two hundred of NPOs were given tax-deductible status by the government which meant that only contributions to those organizations were tax deductible for the contributors.

## South Africa

In South Africa, charities issue a tax certificate when requested by donors which can be used as a tax deduction by the donor.

1. Non-Profit-Organisation are registered under Non-Profit-Organisation Act in South Africa;
2. Trust are registered by the Master of the High Court of the Republic of South Africa;
3. Section 21 Company registered under the Company's Act as amended in the Republic of South Africa;

All non-profit-organisations are classified as Voluntary Organisations and they must be registered for Tax South Africa Revenue Services "SARS", notice of incorporation and signature is needed.

## United Kingdom

In the UK, many non-profit companies are incorporated as a company limited by guarantee. This means that the company does not have shares or shareholders, but it has the benefits of corporate status. This includes limited liability for its members and being able to enter into contracts and purchase property in its own name. The goals or objects of the company are defined in the Memorandum of Association when the company is formed. The profits of the company (also referred to as the trading surplus) must be invested in achieving these goals and not distributed to the company's members.

In UK, a separate charity commission was set up in as early as 1853, as the official regulatory body charged with the duty of ensuring that "whatever is given or done in the name of charity is directed to the purposes and the beneficiaries for whom it is intended".

In UK and in many other countries, there is a comprehensive regulatory framework, including a statement of recommended practices (SORP) issued by the Charities Commission, which sets out recommendations on the way in which a charity should report annually on resources entrusted to it and the activities it undertakes<sup>11</sup>.

Since the Companies act 2006, non-profit companies may be formed as a Community Interest Company (CIC). These are forms of company limited by guarantee or company limited by shares but with special conditions and are intended specifically to ensure that the profits and assets of the company are used for public good, even when managed for (limited) profit.

In UK, a charity is a non-profit organisation that meets stricter criteria regarding its purpose and the method through which it makes decisions and reports its finances. For example, a charity is generally not allowed to pay its Trustees. In England and Wales, charities may be registered with the Charity Commission. In Scotland, the Office of the Scottish Charity Regulator serves the same function. Other organizations which are classified as nonprofit organizations elsewhere, such as trade unions, are subject to separate regulations, and are not regarded as "charities" in the technical sense.

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<sup>11</sup> *Technical guide on accounting and auditing in NPOs, ICAI, Feb, 2003.*

## United States

In the United States, to be exempt from federal income taxes the organization must meet the requirements set forth by the Internal Revenue Services.

After a recognized type of legal entity has been formed at the state level, it is customary for the nonprofit organization to seek tax exempt status with respect to its income tax obligations. That is done typically by applying to the Internal Revenue Service (IRS), although statutory exemptions exist for limited types of nonprofit organizations. The IRS, after reviewing the application to ensure the organization meets the conditions to be recognized as a tax exempt organization (such as the purpose, limitations on spending, and internal safeguards for a charity), may issue an authorization letter to the nonprofit granting it tax exempt status for income tax payment, filing, and deductibility purposes. The exemption does not apply to other Federal taxes such as employment taxes. Additionally, a tax-exempt organization must pay federal tax on income that is unrelated to their exempt purpose. Failure to maintain operations in conformity to the laws may result in an organization losing its tax exempt status.

Individual states and localities offer nonprofits exemptions from other taxes such as sales tax or property tax. Federal tax-exempt status does not guarantee exemption from state and local taxes, and vice versa. These exemptions generally have separate application processes and their requirements may differ from the IRS requirements. Furthermore, even a tax exempt organization may be required to file annual financial reports (IRS Form 990) at the state and federal level. A tax exempt organization's 990 forms are required to be made available for public scrutiny.

## Chapter 4

# Problems, Issues, Misuse of Tax Exemptions by the Cooperatives and NPO Sector

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A study titled "Invisible, yet widespread: The Non-Profit-Sector in India" conducted by Participatory Research in India (PRIA) in collaboration with John Hopkins University, revealed that there are nearly 12 lakhs NPOs in India, which employ more than 2 crores persons as paid or voluntary workers and contribute more than 15% to gross product based on paid employment. This clearly shows the vastness and importance of the NPO Sector. But this is not the case that all NPOs are wholly contributing to their causes. Many of these NPOs have siphoned off money without contributing much to their causes, thus misutilising the tax exemption benefits for personal gains.

Starting from the transparency on sources of funds, nature of activities, complete disclosure of accounts and records along with a robust audit mechanism is the area where policy changes are required.

It is well known that voluntary organizations are person-centric. A number of prominent organizations have been headed by one person by a number of years<sup>12</sup>.

Cooperatives and NPO Sector are accountable only to themselves barring some here and there laws. Tax exemptions are widely used for the personal benefits and promotions by the founders. FCRA regulations have not been able to check fraudulent activities. However, recently in 2012, thousands of NPOs have been de-registered for the violations of FCRA provisions. Many NPOs are used as shield to provide back door support to the private companies.

There seems to be a complete lack of mechanisms of accountability and transparency in the Cooperatives and NPO Sector. These are being run like personal fiefdoms. Arbitrary hire and fire policies, violations of minimum wage regulations, unfair working hours, and rampant anti-social and anti-national behaviour of many NPOs have created the atmosphere of more vigilant role by the Government.

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<sup>12</sup> "Voluntary Sector and Credibility Issues", *E&PW*, June 26, 2004, Page-2679.

Taxation laws allow certain privileges and incentives for promoting charitable activities. Misuse of such benefits and manipulations through entities claimed to be constituted for nonprofit motive are among possible sources of generation of black money<sup>13</sup>.

There is absence of uniform financial reporting, there is lack of transparency in reporting and as such comparison of NPOs is not possible. A large number of NPOs are small in size, unregistered, do not have paid staff and operate as 'associations'<sup>14</sup>.

The growing national and international level recognition and increasing dimension of funding has been leading to mushrooming growth of voluntary organizations. In fact, such a galloping growth has not been very productive in enhancing their strength and has eroded away the virtues and qualities of voluntary actions. Moreover, NGOs have now changed their focus from the traditional relief, rehabilitation, charity and welfare activities to move towards developmental endeavours. To be specific, the overdependence of NGOs on the government for financial and technical assistance has greatly affected the transparency and autonomy of those organizations and that is why the need for existence and effectiveness of governance mechanism in the form of a system of checks and balances to monitor and manage the functioning and performance of the NGOs has been seriously felt now. Since, effective governance is the key towards achieving the objective of building a strong and sustainable social sector and truly, an organization with effective governance will be like a rubber band elastic to its circumstances and needs, and an organization without effective governance is like a balloon as it will burst as it gets more resources.<sup>15</sup>

## Problems experienced by NPOs<sup>16</sup>

Capacity building is an ongoing problem experienced by NPOs for a number of reasons. Most rely on external funding for example government funds, grants from charitable foundations, direct donations etc. to maintain their operations and changes in these sources of revenue may influence the reliability or predictability with which the organization can hire and retain staff, sustain facilities, create programs, or maintain tax-exempt status. For example, a university that sells research to for-profit companies may have

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<sup>13</sup> *White paper on black money, May 2012, Ministry of Finance, Page 7.*

<sup>14</sup> *NPOs-Accounting and Financial Reporting Framework, Indian Journal of Public Administration, Vol. LI, Oct-Dec 2005, Page-813.*

<sup>15</sup> *Code of Governance for NGOs published by the ICAI, Page 5.*

<sup>16</sup> <http://en.wikipedia.org>.

tax exemption problems. In addition, unreliable funding, long hours and low pay can result in employee retention problems. During 2009, the US government acknowledged this critical need by the inclusion of the Nonprofit Capacity Building Programme in the Serve America Act. Further efforts to quantify the scope of the sector and propose policy solutions for community benefit were included in the Nonprofit Sector and Community Solutions Act, proposed during 2010.

Founder's syndrome is an issue organizations face as they grow. Dynamic founders with a strong vision of how to operate the project try to retain control of the organization, even as new employees or volunteers want to expand the project's scope or change policy.

Resource mismanagement is a particular problem with NPOs because the employees are not accountable to anybody with a direct stake in the organization. For example, an employee may start a new program without disclosing its complete liabilities. The employee may be rewarded for improving the NPO's reputation, making other employees happy, and attracting new donors. Liabilities promised on the full faith and credit of the organization but not recorded anywhere constitute accounting fraud. But even indirect liabilities negatively affect the financial sustainability of the NPO, and the NPO will have financial problems unless strict controls are instated.

However, Measuring an NPO by its monetary size has obvious limitations, as the power and significance of NPOs are defined by more qualitative measurements such as effectiveness at performing charitable missions. There are also millions of smaller NPOs that provide social services and relief efforts to people throughout the world.

It may be observed that in the cooperative sector in India, the managements of the cooperative societies have been largely made accountable to the government, and not the members at large, as also the depositors in cooperative banks, who form the vast body of stakeholders<sup>17</sup>.

In India, Cooperatives are used as personal fiefdoms of politicians. Bureaucrats are imposed by the government on the functioning of the cooperatives. It is high time that cooperatives are freed from the control of politicians and bureaucrats.

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<sup>17</sup> "Accountability of the cooperative sector in India", *Mainstream*, June 17-23, 2005, Page-30.

## Chapter 5

# Responses from Select Group

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The taxation laws of Cooperatives and NPO Sector are highly complex and have always been the subject matter of frequent amendments. Cooperatives and NPO Sectors are to a great extent misused as a medium of tax evasion on the pretext of providing social benefits and due to these reasons the Government seems to be keen to bring all the Cooperatives and NPO Sectors claiming exemption of their income under the Income-tax Act into tighter scrutiny in the coming years.

For the purposes of the current research paper, a questionnaire was prepared and responses were sought from a select group of people such as Chartered Accountants, Advocates and experts (select group) working in the field of Cooperatives and NPO Sector.

Questions such as whether taxation laws, regulation and policies are in harmony with the needs of the Cooperatives and NPO Sectors and their views on the reforms required were posed to the select group. The complete questionnaire has been attached in **APPENDIX IV**.

### Summary of Responses from Select Group

The responses of the select group are summarized in brief as given hereunder.

- The select group was of the opinion that the Cooperative movement along with the NPO Sector has been proved to be a catalyst for the overall development of the country and happiness and well-being of the people at large.
- Cooperative societies and NPOs have supplemented the role of welfare state of the Government of India and State Governments to a large extent.
- Cooperative societies and NPOs have provided/created immense employment opportunities for the people.
- Cooperative societies and NPOs have helped in increasing the agriculture and other production.
- They have increased awareness about the benefits of health, education etc. and awakened the people for their rights and duties to each other and the country as well.

- The tax benefits provided to the cooperatives and NPO Sector by the Government are undoubtedly required in the view of role being played by them in the interest of the society.
- Taxation laws, regulation and policies need to be harmonized with the needs of the Cooperatives and NPO Sectors in the changed scenario.
- Tax exemptions help in capacity building and therefore it should be continued.
- The misuse of income/revenue/resources by the founders/management for their personal benefits etc. must be minimized by use of more and more strict measures such as increased audit compliance, social rebuke, more transparency and accountability measures.
- Opinion and debates are required to assess whether cooperatives and NPOs should come under the purview of Right to Information Act, 2005.
- Although legal restrictions and compliance are required to monitor the end use of the tax exempt money on the pretext of fulfillment of social objectives, they should not impose undue hardships on enjoyment of tax exemptions by the Cooperatives and NPO Sectors.
- Cooperatives and NPOs are provided tax benefits globally in almost all mainstream countries as they play a very important role to achieve social objectives and India must continue to achieve the position of the world leader in promotion and development of the cooperatives and NPO Sector by the measures of tax exemption.
- A central regulator on the lines of SEBI, RBI, IRDA etc. may be created for proper regulation of the cooperatives and NPO sector on the basis of experienced gained and in view of changing social, economic and political scenario in respect of taxation and other regulatory matters.
- A central database about the cooperatives and NPO sector in order to achieve more transparency seems to be the need of the time.

## Chapter 6

# Change in thought Line of Government, Changes Proposed and the Way Forward

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### Change in the thought line of Government

From the Eighth Plan onwards, the thrust of the Planning Commission has been to open up a space for NGOs consistent with liberalizing the country's economy and ushering in the era of public-private partnerships. With the introduction of new economic policies in the early 1990s, massive infusions of aid began to pour into the country, notably from international financial institutions like the World Bank, IMF and ADB, each tied to structural conditions: market friendly restructuring, corporatization and privatization of public enterprises and utilities, creating a flexible labour force, removing regulations and so on. These structural adjustments entailed the systematic dismantling of the country's fragile public services and the retreat of the state from essential sectors like food and water supply, education, healthcare and so on. This has left the poor to pretty much fend for themselves, without a say in the direction in the country's fast track development path, without an administration to confront when displaced and disenfranchised to make room for such development, and of course without any claim on the dubious fruits of such development<sup>18</sup>.

Recently, Government has started the implementation of the tax provisions in strict measures. Ever increasing Government expenditure, widening of fiscal deficits, and abuse of the tax laws by some of the NPOs etc. have prompted Government to widen the taxation base in this area also. On the one side, tax benefits to the Cooperatives and NPO Sectors actually benefit the society as a whole while on the other side some people in the garb of working in NPO Sectors have been misusing the tax exemption for the personal benefits.

### Report by Financial Express<sup>19</sup>

"Having failed to locate 25 lakhs out of the 32 lakhs societies registered under the archaic Society Registration Act of 1860, the central government

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<sup>18</sup> *Economic and Political Weekly*, Oct 21, 2006, Page 4407.

<sup>19</sup> <http://www.financialexpress.com>.

now plans to empower itself to take over, suspend, penalize, confiscate, cancel, impose financial and penal penalties, and investigate any and every society or its properties that operates in multiple states. In order to do so, it has just floated the draft of 'Multi-State Societies Registration Bill, 2012'.

Once this Bill becomes a law, all societies, either registered under the old law, or the new ones, will have to mandatorily register themselves in accordance with the stringent provisions of the proposed law. Also, all such societies will have to file annual reports, balance sheet and details of office bearers among others with MCA-21 of the ministry of corporate affairs as the Bill proposes to treat all multi-state societies as corporate bodies. The proposed Bill will also strengthen the inflow of funds to such societies including those received from overseas.

The Bill will impact a whole host of societies including religious societies, sporting bodies (BCCI, IOA, others), NGOs etc.

A recent government report states that the financial output of 7 lakhs societies surveyed stood at ₹ 42,000 crores in one fiscal year. The report also states that 54% of the funding for these societies comes from grants while 16% is from donations and offerings and 16% from incomes/receipts from operations.

The Bill being floated by the Ministry of Corporate Affairs (MCA) for comments and suggestions from the stakeholders proposes power to the central government to cancel registration of societies if any multi-state society registered under this Act has furnished false or misleading documents for obtaining registration or has failed to comply with the provisions of this Act. However, the draft Bill states: "No cancellation shall be done by the central government without affording the multi-state society an opportunity of being heard".

The Bill makes it clear that all accounts of a multi-state society shall be audited by the auditors if the gross receipts or expenditure in a financial year exceeds ₹ 5 lakhs.

According to a special study commissioned by the MCA, a number of countries are already in the process of implementing a centralized law and centralized reporting requirements related to regulation of societies and firms (partnership and proprietorship). These countries include Singapore, Australia and South Africa among others.

"It is desirable that India follows their lead for regulatory reporting mechanisms and a centralized reporting system under the MCA-21 platforms

is established for partnerships, proprietorships and societies that operate outside the confines of one state," sources in MCA said.

As a result, the Multi-States Society Bill, 2012, proposes that all societies registered under this Act will have mandatory annual reporting requirements, mandatory maintenance of books of accounts and the multi-state bodies will be deemed to be a corporate body.

"The movable and immovable property, belonging to a multi-state society shall be deemed to be vested in the multi-state society."

The proposed law also gives the power to the Central government to take over the affairs of a multi-state society if it feels that the conduct of the society is against public interest. If such an occasion arises, the central government can either take a direct control over the body or appoint person or body of persons to oversee the management of such a society."

## **Report by the Times of India<sup>20</sup>**

The non-profit sector is expected to face tough scrutiny from the taxman in the coming days as the income tax department suspects that charitable institutions are being used to avoid tax payment. A senior official said the focus would specifically be on educational institutions, considering that several politicians in the South and Maharashtra were associated with them and most of them were being run by trusts or through charitable institutions. "Several businesses are also run under the garb of charitable work and we provide exemption to them," the official said.

A case in point was the Board of Control for Cricket in India which till recently enjoyed tax exemption due to its status as a charitable institution. The government has already proposed to tighten the norms for them over the years and provisions have also been incorporated in the Direct Taxes Code Bill to ensure that only genuine entities undertaking charitable work get the exemption.

Besides, the department is trying to strengthen tax enforcement for this sector as several of the trusts might also act as money laundering vehicles. "From registration onwards things are in a mess," said an official.

So, the income tax department has set up an internal committee to look into the matter. At present, if an entity wants to avail of tax benefits, which could be exemption, it needs to get a clearance from the government. For this, it

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<sup>20</sup> <http://timesofindia.indiatimes.com>.

can register either with the directorate of exemption or file an application with an income tax commissioner. But there is no way for the two to tally their records, creating a situation where an entity can get away easily. The committee is expected to suggest ways to plug these gaps.

## Report by Business Standard<sup>21</sup>

When the honourable Prime Minister was inviting active participation of the civil society in ensuring effective delivery of his government's ambitious development agenda for millions of aam admi from the ramparts of the Red Fort on this Independence Day, he was perhaps unaware of the fatal implications of the new Income Tax Code released only three days before by his own Finance minister.

Tinkering with various Sections of the Income Tax Act 1961, as it governs the non-profit (voluntary, charitable, civil society, call what you may) organisations (NPOs), has been going on for nearly three decades now. Sometimes, only religious publications are allowed as tax exempt, and sometimes other educational publications are also included. Sometimes, business income incidental to the achievement of the core objects of an NPO is allowed as tax exempt, sometimes disallowed. Most recently, the Finance Act 2008 had redefined the meaning of tax exempt 'charitable purposes' in such a significant way that purposes other than education, health and relief to the poor were suo moto debarred from tax exemption if they earned any revenue in forms other than donations.

Now comes the new Code, whose Section IV deals with NPOs. What does it imply? It reinforces the amendments of 2008, it further proposes 15 per cent tax on any surplus carried forward (even if it is due to 'funds received in advance'), it gives complete suo moto tax exemption to religious trusts and endowments, and it proposes capital gains tax as well as tax on income from sale of products that an NPO may be supporting local self-help groups to produce. It even changes the very concept of charitable purpose to 'permitted welfare activities'. Tax exemption regime for individual and corporate donors has also been curtailed significantly, thereby implying declining indigenous contributions from the Indian society to the sustainability of the voluntary sector in India.

It is amazing that such sweeping changes affecting the entire non-profit voluntary sector have been proposed without the articulation of a

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<sup>21</sup> <http://www.business-standard.com>.

comprehensive framework of what we as Indians would like the civil society to be contributing to the future development of the country in the next decades. The legal frameworks of Society & Trust determining incorporation of such NPOs date back to colonial periods of 19th century; they club all types of organisations into a single form (so that Apollo Hospitals and primary health care programmes in Jharkhand are treated alike, just as non-formal education of tribal youths in Chhattisgarh is treated in the same manner as Doon School).

The same government of Dr. Manmohan Singh had announced a national policy on the voluntary sector in 2007 and urged various ministries and departments of the Central and state governments to operationalise the policy during the 11<sup>th</sup> Plan. Is this the outcome of that operationalisation? It completely violates all the tenets of that policy.

The makers of this proposed Code have not looked into how voluntary organisations working on various government schemes receive funds nowadays—gone are the days of grants, now funding is done on the basis of contracts based on invited applications to ‘deliver’ certain outputs in a time-bound fashion. In the new Code, this is a taxable business income. If voluntary organisations provide support in the implementation of the National Rural Employment Guarantee Scheme, literacy, women’s empowerment, rehabilitation of child labour, strengthening capacities of panchayats and municipalities, support the enforcement of Right To Information, Domestic Violence and Forest Rights Acts (passed by this same government) through the use of public funds, then they would all be taxed in the future. Who will decide what is ‘permitted welfare activity’? Is this the new licence permit raj in the field of social and human development? What will happen to advocacy campaigns on human rights, child rights, rights of tribals, etc.?

When all sections of Indian society are going global—this government has encouraged business institutions to operate in the global market and proclaimed that India was a donor for many other countries—why is it that the new Code restricts the tax exemption only for domestic operations? Why are Indian NGOs not encouraged to work globally, just as European and North American ones do? Is this not desirable for an emerging India?

It is surprising that these sweeping changes have been proposed without adequate consultations with those who have worked in, studied and championed the growth of a vibrant and active civil society in India over the past three-four decades.

Millions of citizens’ groups, resident welfare associations, mahila mandals and small voluntary organisations in remote rural and urban areas of this

country, and hundreds of social movements have been the sources of alternative thinking, social innovations and critical discourses on models and approaches to development that promotes justice, equity and inclusion in India. Thousands of research and training institutions have contributed immensely to improving the design and delivery of numerous development programmes over the decades. Almost all the schemes and projects of the Central and State governments now invite voluntary organisations to join in their implementation. None of this will survive if the proposed Code is allowed to be implemented in its current form.

Perhaps that is what the political, official and business elites of this country want anyway.

## **Expert Group Report on Societies Registration Act 1860**

An Expert Group was constituted by Ministry of Corporate Affairs to study the legislative and regulatory architecture of the Societies Registration Act, 1860 and to understand and gauge the ground level situation of societies operating in India at present.

The Group realized that that there are two different types of societies operating in India, one whose functions are restricted to only one state only and others, whose activities are spread in more than one state and it has drafted a Bill in respect of societies having multi- state operations which is called a Multi-State Societies Registration Bill, 2012 (MSSRB, 2011). A model law governing the registration of societies having operation limited to one state will also be prescribed soon but the said law will have to adopted and enacted by each State separately.

It is to be further noted that at present there is no exclusive law governing the functioning of multi-state based societies. The Expert Group has drafted the bill governing the functioning of Multi-State Societies. The Bill seeks to regulate the working of Multi-State Societies by providing discloser and reporting requirements and more powers to Central Government.

Moreover the current Societies Registration Act is very weak and doesn't provide for effective regulation of working of the Societies. Though the Societies are required to submit document to Registrar of Firm from time to time but Societies hardly do the same. Moreover since Societies are not required to disclose their accounts therefore they are not subject to public scrutiny and lack transparency.

As per the expert committee report there are more than 30 Lakh societies that are registered in India, assuming the numbers, the new law will create a drastic impact on the working of all these.

*Highlights of the Bill are as follows:*

- ❖ The Bill proposes to provide an enabling framework for the registration and functioning of the multi-state societies. The definition of what constitutes a 'multi-state society' would be determined by the objective and nature of their activities as per the provision of the Proposed Bill
- ❖ No Multi-State Society can carry any inter-state activity without being registered under this Act. Existing multi-state societies registered under the Societies Registration Act should, either register under this Act or stop carrying such activities within the prescribed time. Failure to obtain registration is an offence punishable under the proposed Bill.
- ❖ Every such society will now have to maintain books of accounts, on all receipts and expenditure, sales and purchases of goods and assets and liabilities of the society.
- ❖ Members of the society can inspect its books and accounts, which was not allowed earlier.
- ❖ The bill provides elaborate provisions for Inspection, Inquiry and Investigation into the affairs of the society by the Central Government, which were not there earlier.
- ❖ Penalties have been provided in case of furnishing false information, statement or destruction of records.
- ❖ Members of Governing body of Society have to obtain a Governing Body Identification Number on the line of Director Identification Number for Directors in case of Companies.
- ❖ The Bill also provides elaborate provisions for the registration of foreign societies having place of business in India, which is not allowed currently. A foreign society is defined as a society or other association of individuals incorporated outside India within the meaning of Foreign Exchange Management Act, 1999.
- ❖ Provision has been made to regulate the interest of the members in the contracts executed or entered into by the Societies.
- ❖ The Bill will also provide the formats in which the Financial Statement of the Society have to be prepared.

## **Amendment of the Multi-state Co-operative Societies Act, 2002**

The objective of Multi-State Co-operative Societies (MSCS) Act 2002 was to facilitate the organization and functioning of the cooperative societies having jurisdiction in more than one States. The Act intended to facilitates voluntary formation and democratic functioning of multi-state cooperative societies as member driven institutions based on self-help and mutual aid and to enable them to promote their economic and social betterment and provides for functional autonomy.

Based on the experience of implementation of the MSCS Act, 2002, interaction and feedback received from various stakeholders including the multi- state co-operative societies and recommendations made by the High Powered Committee on Cooperatives constituted by the Government of India under the chairmanship of Shri S.O. Patil, a need was felt to further amend the Multi-State Co-operative Societies Act, 2002 to keep the legislation in tune with the changing economic policies and to facilitate the multi-state co-operative societies to take advantage of the new and emerging opportunities.

The Union Cabinet has approved the introduction of the Multi-State Cooperative Societies (Amendment) Bill, 2010. These amendments are intended to enhance the public faith in the cooperatives and to ensure better accountability of the management towards its members and the law of the land.

Following are the proposals in the new bill:

- It has been proposed to define active member to ensure the member's active participation in the affairs of the society.
- The Directors will also be required to disclose the interest of their relatives in the affairs of the society.
- It is proposed that every society shall be required to constitute an Audit and Ethics Committee of the Board. The existing restriction on borrowings by the society is proposed to be relaxed.
- The proposed amendments also include the provisions for filing of applications, documents, inspections, payment of fees, charges and issuance of certificates of registration and maintenance of documents by Central Registrar in electronic forms. It also provides for cancellation of registration if obtained by misrepresentations of facts, submission of false or misleading information, suppression of material facts or fraud etc. Reservation of seat for the SC/ST and women on

the board, constitution of interim board of experts for rehabilitation of a sick society, election authority for conduct of election and Cooperative Rehabilitation and Reconstruction Fund for rehabilitation and development of cooperative societies have also been proposed.

- The proposed amendments also include provision for Cooperative Information Officer and Appellate Authority to provide information to the members about the affairs and management of the society; penal provisions for non-filing of returns; non-admission of new members by the administrators when the board is under supersession; obligation on the part of a Multi-States Co-operative Society to make available its products and services to its members and their patronage by the members, etc.

### **Article published in the Business Line print edition dated September 17, 2010**

The multi-state co-operative societies can now reduce or eliminate Government control over them by refunding full or part of the share capital subscribed by the Government, through a new clause in the Multi-State Cooperative Societies (MSCS) (Amendment) Bill, 2010, passed in Parliament today.

The MSCS Act of 2002 has been amended to keep in tune with the growing economy and allow MSCS to take advantage of the emerging opportunities, according to a PIB release.

Henceforth, it will become imperative to define active member to ensure the member's active participation in the affairs of the society, and take a time-bound decision in the process of admitting members in order to prevent inordinate delays.

The co-opted directors will need to have experience in the field of banking, management, finance or specialization in any field relating to the objects and activities undertaken by the MSCS. It will be mandatory for directors to disclose the interests of their relatives in the affairs of the society.

The members will have to make their payment due to the society if they want to exercise their rights. The existing restriction on borrowings by the society will be relaxed.

The other proposals in the Bill include reservation of seat for the SC/ST and women on the board, constitution of interim board of experts for rehabilitation of a sick society and Cooperative Rehabilitation and Reconstruction Fund for development of cooperative societies.

## Chapter 7

# Compulsory Tax Audit of Cooperatives and NPO Sectors- Need of Time

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Audit of accounts in the corporate sector had been made compulsory by legislation many years back, and later on, realizing the importance of audit, government extended this requirement to non-corporate sector also.

Section 44 AB was inserted in Income Tax Act, 1961 in the year 1984 by the Finance Act, 1984, effective from assessment year 1985-1986.

### Idea behind Introduction of Section 44AB

Finance Minister while presenting the Union Budget for 1984-85, observed;<sup>22</sup>

*"In order to discourage tax avoidance and tax evasion, I am also introducing some further measures. In all cases where the annual turnover exceeds ₹ 20 lakhs or where the gross receipts from a profession exceed ₹ 10 lakhs, I am providing for a compulsory audit of accounts. This is intended to ensure that the books of account and other records are properly maintained and faithfully reflect the true income of the taxpayer."*

The compulsory audit was intended to ensure proper maintenance of books of account and other records, in order to reflect the true income of the tax payer and to facilitate the administration of tax laws by a proper presentation of the accounts before the tax authorities. This was also intended to save the time of the Assessing Officers considerably in carrying out the verification.

### Experience from Tax Audit

In the last 27 years, tax audit has brought transparency and ensured accuracy in the books of accounts filed with the tax authorities. It has helped in educating the tax payers and increasing self-compliance by the tax payers. Tax audit has also contributed a lot in creating an awareness of the tax provisions and encouraging voluntary compliance.

On the basis of experience gained, about the benefits of tax audit, its scope has been being widened from time.

In fact, the introduction of the provisions regarding compulsory audit of accounts for tax purposes under section 44AB have proved to be a very

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<sup>22</sup> Budget Speech of Finance Minister for 1984-85 (Para 71, page-14).

healthy development in the Indians taxation laws. It has become a very useful tool in the hands of the government machinery responsible for the implementation of the provisions of taxation laws.

## Guidance Note on Tax Audit u/s 44AB issued by ICAI,<sup>23</sup>

Guidance Note on Tax Audit u/s 44AB issued by ICAI provides as follows:

### Liability to tax audit - Special cases

*A question may arise in the case of an assessee whose income is not chargeable to income tax by reason of a specific exemption contained in the law or otherwise, as to whether he is required to get his accounts audited and to furnish such report under section 44AB. Such cases may cover those assesseees who are wholly outside the purview of income tax law as well as those whose income is otherwise exempt under the Act. It is felt that neither section 44AB nor any other provisions of the Act stipulate exemption from the compulsory tax audit to any person whose income is exempt from tax. This section makes it mandatory for every person carrying on any business or profession to get his accounts audited where conditions laid down in the section are satisfied and to furnish the report of such audit in the prescribed form. A trust/association/institution carrying on business may enjoy exemptions as the case may be under sections 10(21), 10(23A), 10(23B) or section 10(23BB) or section 10(23C) or section 11. A cooperative society carrying on business may enjoy deduction under section 80P.*

*Such institutions/associations of persons will have to get their accounts audited and to furnish such audit report for purposes of section 44AB if their turnover in business exceeds ₹ 40 lakhs. But an agriculturist, who does not have any income under the head "Profits and gains of business or profession" chargeable to tax under the Act and who is not required to file any return under the said Act, need not get his accounts audited for purposes of section 44AB even though his total sales of agricultural products may exceed ₹ 40 lakhs.*

*It may be appreciated that the object of audit under section 44AB is only to assist the Assessing Officer in computing the total income of an assessee in accordance with different provisions of the Act. Therefore, even if the income of a person is below the taxable limit laid down in the relevant Finance Act of a particular year, he will have to get his accounts audited and to furnish such report under section 44AB, if his turnover in business exceed ₹ 40 lakhs.*

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<sup>23</sup> Guidance Note on Tax Audit u/s 44AB (Para 6).

*The case of non-residents may be considered separately. Section 44AB does not make any distinction between a resident or non-resident. Therefore, a non-resident assessee is also required to get his accounts audited and to furnish such report under section 44AB if his turnover/sales/gross receipts exceed the prescribed limits. This audit, however, would be confined only to the Indian operations carried out by the non-resident assessee since he is chargeable to income-tax in India only in respect of income accruing or arising or received in India.*

## **Case of Compulsory Tax Audit for Cooperatives and NPO Sectors- Need of Time**

The Income Tax Act provides for the audit of accounts of public charitable trusts and non-corporate assess. Section 142(2A) has given wide powers to the tax authorities to get the accounts in certain specified circumstances, audited by a chartered accountant. Introduce of section 44AB has considerably widened the scope of audit.

### *Some Special Issues in Co-operative and NPO Sectors*

- ❖ *Educational and charitable trusts charge capitation fee at the time of giving admission , but garb it as voluntary donations received towards corpus fund,*
- ❖ *They make payments/expenses outside the registered trust and show as application of surplus fund towards charitable/educational purposes,*
- ❖ *Payments are made to concerns where trustees are interested as partners/directors,*
- ❖ *Trusts/NPOs/Cooperatives give heavy salaries to promoters, spend heavily on advertisement of commercial nature and apply many more methods in the garb of charitable purposes.*

Widening the scope of tax audit u/s 44AB further and bringing Cooperatives and NPO Sectors within its ambit shall certainly help in fulfillment of the mission and vision of the Income Tax department<sup>24</sup> in the following ways:

- ✓ *In formulating progressive tax policies,*
- ✓ *In making compliance easy,*
- ✓ *In enforcing tax laws with fairness,*

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<sup>24</sup> *Let Us Share, A Compilation of Best Practices & Orders by Income Tax Department (Page-5).*

- ✓ *In delivering quality services, and*
- ✓ *In continuously upgrading skills and build a professional and motivated workforce.*

Tax audit shall also help Co-operatives and NPO'S in the following ways:

- *To be trustful and prompt in meeting all legal obligations,*
- *To avoid non-deduction of TDS and non-collection of TCS and to pay TDS and TCS amounts and file returns on time along with compliance of PAN and loans etc. as tax collection at source (TCS) and tax deduction at source (TDS) have now become highly significant modes of collection of income tax. TDS and TCS jointly contribute about 38% of tax collection.<sup>25</sup>*
- *It will develop a healthy tax culture where the taxpayers and the tax collectors discharge their obligation with the required knowledge and information and with a sense of responsibility.*
- *Income tax department comes across huge suspicious transactions and trends in co-operatives and NPO sectors every year. Tax audit shall certainly help income tax department in suitable enquires and taking deterrent action.*

Provisions of section 44AB have also been upheld by Hon'ble Supreme Court in T.D. Venkata Rao v. Union of India [1999] 237 ITR 315 (SC). The Apex Court has made the following significant observations:

*"Chartered Accountants, by reason of their training have special aptitude in the matter of audits. It is reasonable that they, who form a class by themselves, should be required to audit the accounts of businesses whose income (sic: turnover) exceeds ₹ 40 lakhs and professionals whose income (sic: gross receipts) exceeds ₹ 10 lakhs in any given year. There is no material on record and indeed in our view, there cannot be that an income-tax practitioner has the same expertise as chartered accountants in the matter of accounts."*

At last, it may be concluded that tax audit requirements have placed a tremendous responsibility on the practicing Chartered Accountants in carrying out the audit and in furnishing the audit report setting forth the prescribed particulars and it is needless to say that the Chartered Accountants would again, justify the confidence, if reposed by the Income Tax Department/Government by enlarging the scope of tax audit u/s 44AB, for inclusion of Cooperatives and NPO Sectors also within its ambit.

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<sup>25</sup> *Ibid*, Page-29.

## Chapter 8

# The Way Forward

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Cooperatives and NPO Sector is a vast but to a large extent unregulated sector. Bringing them into the RTI and Lokpal type legislations is a considerable option along with creating a SEBI like regulator as a central agency.

The role of shareholders is often emphasized as a manner of ensuring the accountability of management. But there is no great merit in accountability to shareholders, since that accountability is limited to earning profits and enhancing share values<sup>26</sup>.

“With increasing globalization, liberalization and de-regulation, the international forces have influenced the economic and social forces at the national and local levels thus resulting in an increasing development and powerlessness of the people particularly, among the poor and marginalized sections of the society.

Here comes in the role of Non-Governmental Organizations (NGOs), to emerge as a viable institutional framework generally recognized as a voluntary sector, to serve as a catalyst for development and change.

The voluntary sector has evolved as a viable third-sector, in the third world, next to the government and private sectors and the NGOs with their participatory approach, people mobilizing capacity, closeness to grass roots and better insights into the needs of the people have emerged as alternative development agents rather that sector has become an effective means of the process of empowerment.

As the economy becomes global and market-oriented, the state has been shrinking in the functions and resources and unable to meet the growing social/welfare and developmental challenges. On the other hand, the profit motivated private enterprises, though expanding rapidly, are little concerned with the social developmental considerations and rural development. Therefore, neither the state-led nor the market-led model of development is adequate in achieving the developmental goals. Hence, the role of the third sector, i.e., the voluntary sector, assumes a special significance and it gains wide recognition nationally and internationally.<sup>27</sup>

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<sup>26</sup> Economic and Political Weekly, June 26, 2004, Page 1643

<sup>27</sup> Code of Governance for NGOs published by the ICAI, Page 4

"There <sup>28</sup>are several fiscal and regulatory privileges under different laws available to non-profit and cooperative organisations. Their income, subject to various conditions, is treated differently for taxation purposes from that of privately owned profit-oriented concerns. This creates incentives for potential evaders to camouflage their concerns as non-profitable, charitable, or cooperative in nature. This can only be dealt with through a multi-pronged strategy of reducing the privileges available to them on one hand and subjecting them to a stricter regulatory regime on the other. However, given the role of genuine NPOs in the welfare of the downtrodden and the broader government policy of supporting such endeavours, this is a somewhat complex issue that may easily evoke strong emotional responses and hence can be implemented only after a larger consensus is reached within society.

At present, no government agency has a complete database of NPOs. The CBDT has the largest such database. There may be information with other agencies such as the Ministry of Home Affairs and the CEIB. It has been suggested that the CBDT may be assigned the role of a centralized agency with which every NPO would be required to be registered and by which it would be allotted a unique number. This would be in line with the decision taken by the government in light of the possible misuse of the sector for undesirable activities. Suggestions made by the NPO Sector Assessment Committee, an Inter-ministerial body, should be accepted and the office of the Director General of Income Tax (Exemption) appropriately strengthened in terms of manpower, infrastructure, and capacity building.

The regulation and enforcement of KYC norms in the cooperative sector may be strengthened by the state governments as well as the central government. Responsibility may be fixed for any lapse in this regard as well as for any subsequent failure to alert authorities as regards any suspicious transactions in such accounts."

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<sup>28</sup> White paper on black money, May 2012, Ministry of Finance, Page 57

# Conclusions and Suggestions

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## Conclusions

On the basis of above laws, discussions and study, it may safely be concluded that the Cooperative societies along with the NPO Sector have been proved to be a catalyst for the overall development of the country and happiness and wellbeing of the people at large.

Cooperative societies and NPOs have supplemented the role of welfare state of the Government of India and State Governments to a large extent. Cooperative societies and NPOs have provided and created immense employment opportunities for the people of the country.

Cooperative societies and NPOs have helped in increasing the agriculture and other production. They have increased awareness about the benefits of health, education etc. and awakened the people for their rights and duties.

The tax benefits provided to the cooperatives and NPO Sector by the Government are undoubtedly required in the view of the role being played by them in the interest of the society but there is also an urgent need to harmonize taxation laws, regulation and policies with the needs of the Cooperatives and NPO Sectors in the changed scenario.

Tax exemptions help in capacity building and therefore it should be continued with a caveat that the misuse of income/revenue/resources by the founders/management or other persons for their personal benefits etc. must be minimized by the use of more and suitable strict measures such as increased audit compliance, social rebuke, more transparency and accountability measures etc.

Further, there is a need of opinions and debates on public platforms so as to assess whether Cooperatives and NPOs should come under the purview of Right to Information Act, 2005 and Lokpal type of legislations.

Cooperatives and NPOs have been provided with tax benefits globally in almost all mainstream countries as they play a very important role to achieve social objectives and India must continue to achieve the position of the world leader in promotion and development of the Cooperatives and NPO Sector by the measures of tax exemption *inter alia*. A central regulator on the lines of SEBI, RBI, IRDA etc. may be created for proper regulation of the cooperatives and NPO sector on the basis of experience gained and in view of changing social, economic and political scenario so as to strengthen taxation and other regulatory matters. A central regulator along with a central

database for the Cooperatives and NPO sector seems to be the need of the time.

## Suggestions

Now on the based on the above laws, study, discussions and conclusions drawn, the research paper suggests the following:

1. A standard set of proper norms and practices are required for Cooperatives and NPO Sector.
2. Cooperatives and NPO Sector lack accountability and transparency and measures to ensure the same are required.
3. Trust and credibility of the Cooperatives and NPO Sector needs to be enhanced in the eyes of public at large through proper reforms and fair practices.
4. Penalties and other measures need to be strengthened on the organizations in Cooperatives and NPO Sector, working for tax evasions in the garb of working not for profit.
5. More disclosures on payments, remunerations and reimbursements to the founders and managers are required.
6. A Central regulatory authority on the lines of SEBI, RBI, IRDA etc. with a central database for Cooperatives and NPO Sector is required.
7. Strict documentation, accounting and audit mechanism needs to be put in place for Cooperatives and NPO Sector including tax audit.
8. Taxation laws, regulation and policies need to be harmonized with the needs of the Cooperatives and NPO Sectors in the changed scenario.
9. The misuse of income/revenue/resources by the founders/management for their personal benefits etc. must be minimized by the use of more and more strict measures such as increased audit compliance, social rebuke, more transparency and accountability measures etc.
10. Opinion and debates are required to assess whether cooperatives and NPOs should come under the purview of Right to Information Act, 2005 and Lokpal type of legislations.
11. Credit rating of the Cooperatives and NPO Sector from the practicing Chartered Accountants may be a progressive thought and a robust credit rating mechanism may be developed over a period of time. This will help in release of funds to the deserving organizations and also

- help in ensuring end use of the tax exempt money for the intended purpose.
12. For profit organizations<sup>29</sup> in Cooperatives and NPO Sector may be encouraged.

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<sup>29</sup> For profit organisation in Cooperatives and NPO Sector may be understood as an organisation that applies commercial strategies to maximize improvements in human and environmental well-being, rather than maximizing profits for external shareholders.

# Appendix I

## Important Provisions of Income Tax Act, 1961

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Some Important provisions of the Income Tax Act, 1961 are given hereunder:

As per Section 2 (24) "*income*" includes;

- (ii) voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes or by an association or institution referred to in clause (21) or clause (23), or by a fund or trust or institution referred to in sub-clause (iv) or sub-clause (v) or by any university or other educational institution referred to in sub-clause (iiia) or sub-clause (vi) or by any hospital or other institution referred to in sub-clause (iiia) or sub-clause (via)] of clause (23C) of Section 10 or by an electoral trust.

*Explanation.*—For the purposes of this sub-clause, "trust" includes any other legal obligation.

As per Section 10 (23A), the following income shall be exempt:

any income (other than income chargeable under the head "Income from house property" or any income received for rendering any specific services or income by way of interest or dividends derived from its investments of an association or institution established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other profession as the Central Government may specify in this behalf, from time to time, by notification in the Official Gazette:

Provided that—

- (i) the association or institution applies its income, or accumulates it for application, solely to the objects for which it is established; and
- (ii) the association or institution is for the time being approved for the purpose of this clause by the Central Government by general or special order;

Provided further that where the association or institution has been approved by the Central Government and subsequently that Government is satisfied that—

- (i) such association or institution has not applied or accumulated its income in accordance with the provisions contained in the first proviso; or
- (ii) the activities of the association or institution are not being carried out in accordance with all or any of the conditions subject to which such association or institution was approved,

it may, at any time after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned association or institution, by order, withdraw the approval and forward a copy of the order withdrawing the approval to such association or institution and to the Assessing Officer.

As per Section 10 (23B), the following income shall be exempt:

any income of an institution constituted as a public charitable trust or registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India, and existing solely for the development of khadi or village industries or both, and not for purposes of profit, to the extent such income is attributable to the business of production, sale, or marketing, of khadi or products of village industries:

Provided that—

- (i) the institution applies its income, or accumulates it for application, solely for the development of khadi or village industries or both; and
- (ii) the institution is, for the time being, approved for the purpose of this clause by the Khadi and Village Industries Commission:

Provided further that the Commission shall not, at any one time, grant such approval for more than three assessment years beginning with the assessment year next following the financial year in which it is granted:

Provided also that where the institution has been approved by the Khadi and Village Industries Commission and subsequently that Commission is satisfied that—

## Taxation of Cooperatives and NPO Sectors

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- (j) the institution has not applied or accumulated its income in accordance with the provisions contained in the first proviso; or
- (j) the activities of the institution are not being carried out in accordance with all or any of the conditions subject to which such institution was approved,

it may, at any time after giving a reasonable opportunity of showing cause against the proposed withdrawal to the concerned institution, by order, withdraw the approval and forward a copy of the order withdrawing the approval to such institution and to the Assessing Officer.

*Explanation.*—For the purposes of this clause,—

- (i) “Khadi and Village Industries Commission” means the Khadi and Village Industries Commission established under the Khadi and Village Industries Commission Act, 1956 (61 of 1956);
- (ii) “khadi” and “village industries” have the meanings respectively assigned to them in that Act;]

As per Section 10 (23BBA), the following income shall be exempt:

any income of any body or authority (whether or not a body corporate or corporation sole) established, constituted or appointed by or under any Central, State or Provincial Act which provides for the administration of any one or more of the following, that is to say, public religious or charitable trusts or endowments (including maths, temples, gurdwaras, wakfs, churches, synagogues, agiaries or other places of public religious worship) or societies for religious or charitable purposes registered as such under the Societies Registration Act, 1860 (21 of 1860), or any other law for the time being in force:

Provided that nothing in this clause shall be construed to exempt from tax the income of any trust, endowment or society referred to therein.

As per Section 10 (23C), the following income shall be exempt which has been received by any person on behalf of –

- (i) the Prime Minister’s National Relief Fund; or
- (ii) the Prime Minister’s Fund (Promotion of Folk Art); or
- (iii) the Prime Minister’s Aid to Students Fund; or

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- (iiia)* the National Foundation for Communal Harmony; or
  - (iiiab)* any university or other educational institution existing solely for educational purposes and not for purposes of profit, and which is wholly or substantially financed by the Government; or
  - (iiiac)* any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit, and which is wholly or substantially financed by the Government; or
  - (iiiad)* any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed; or
  - (iiiae)* any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit, if the aggregate annual receipts of such hospital or institution do not exceed the amount of annual receipts as may be prescribed; or
  - (iv)* any other fund or institution established for charitable purposes [which may be approved by the prescribed authority], having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States; or
  - (v)* any trust (including any other legal obligation) or institution wholly for public religious purposes or wholly for public religious and charitable purposes, [which may be approved by the prescribed authority], having regard to the manner in which the affairs of the trust or institution are administered and supervised for ensuring that the income accruing thereto is properly applied for the objects thereof;
  - (vi)* any university or other educational institution existing solely for educational purposes and not for purposes of profit, other than those

mentioned in sub-clause (*iiiab*) or sub-clause (*iiiad*) and which may be approved by the prescribed authority; or

- (*via*) any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit, other than those mentioned in sub-clause (*iiiac*) or sub-clause (*iiiae*) and which may be approved by the prescribed authority;

Provided that the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (*iv*) or sub-clause (*v*) [or sub-clause (*vi*) or sub-clause (*via*)] shall make an application in the prescribed form and manner to the prescribed authority for the purpose of grant of the exemption, or continuance thereof, under sub-clause (*iv*) or sub-clause (*v*) [or sub-clause (*vi*) or sub-clause (*via*)]:

Provided further that the prescribed authority, before approving any fund or trust or institution or any university or other educational institution or any hospital or other medical institution, under sub-clause (*iv*) or sub-clause (*v*) or sub-clause (*vi*) or sub-clause (*via*), may call for such documents (including audited annual accounts) or information from the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, as the case may be, as it thinks necessary in order to satisfy itself about the genuineness of the activities of such fund or trust or institution or any university or other educational institution or any hospital or other medical institution, as the case may be, and the prescribed authority may also make such inquiries as it deems necessary in this behalf:

Provided also that the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (*iv*) or sub-clause (*v*) [or sub-clause (*vi*) or sub-clause (*via*)] –

- (*a*) applies its income, or accumulates it for application, wholly and exclusively to the objects for which it is established and in a case where more than fifteen per cent of its income is accumulated on or after the 1st day of April, 2002, the period of the accumulation of the amount exceeding fifteen per cent of its income shall in no case exceed five years; and

- (b) does not invest or deposit its funds, other than—
- (i) any assets held by the fund, trust or institution or any university or other educational institution or any hospital or other medical institution where such assets form part of the corpus of the fund, trust or institution or any university or other educational institution or any hospital or other medical institution as on the 1st day of June, 1973;
  - (ia) any asset, being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution where such assets form part of the corpus of any university or other educational institution or any hospital or other medical institution as on the 1st day of June, 1998;
  - (ii) any assets (being debentures issued by, or on behalf of, any company or corporation), acquired by the fund, trust or institution [or any university or other educational institution or any hospital or other medical institution] before the 1st day of March, 1983;
  - (iii) any accretion to the shares, forming part of the corpus mentioned in sub-clause (i) [and sub-clause (ia)], by way of bonus shares allotted to the fund, trust or institution [or any university or other educational institution or any hospital or other medical institution] ;
  - (iv) voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the Official Gazette, specify,

for any period during the previous year otherwise than in any one or more of the forms or modes specified in sub-section (5) of Section 11;

Provided also that the exemption under sub-clause (iv) or sub-clause (v) shall not be denied in relation to any funds invested or deposited before the 1st day of April, 1989, otherwise than in any one or more of the forms or modes specified in sub-section (5) of Section 11 if such funds do not continue to remain so invested or deposited after the 30th day of March 1993:

Provided also that the exemption under sub-clause (vi) or sub-clause (via) shall not be denied in relation to any funds invested or deposited

before the 1st day of June, 1998, otherwise than in any one or more of the forms or modes specified in sub-section (5) of Section 11 if such funds do not continue to remain so invested or deposited after the 30th day of March, 2001;

Provided also that the exemption under sub-clause (iv) or sub-clause (v) [or sub-clause (vi) or sub-clause (via)] shall not be denied in relation to voluntary contribution, other than voluntary contribution in cash or voluntary contribution of the nature referred to in clause (b) of the third proviso to this sub-clause, subject to the condition that such voluntary contribution is not held by the trust or institution or any university or other educational institution or any hospital or other medical institution], otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11, after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st day of March, 1992, whichever is later.

Provided also that nothing contained in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) shall apply in relation to any income of the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, being profits and gains of business, unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business:

Provided also that any notification issued by the Central Government under sub-clause (iv) or sub-clause (v), before the date on which the Taxation Laws (Amendment) Bill, 2006 receives the assent of the President, shall, at any one time, have effect for such assessment year or years, not exceeding three assessment years including an assessment year or years commencing before the date on which such notification is issued) as may be specified in the notification:

Provided also that where an application under the first proviso is made on or after the date on which the Taxation Laws (Amendment) Bill, 2006 receives the assent of the President, every notification under sub-clause (iv) or sub-clause (v) shall be issued or approval under sub-clause (iv) or sub-clause (v) or] sub-clause (vi) or sub-clause (via) shall be granted or an order rejecting the application shall be passed within the period of twelve months from the end of the month in which such application was received:

Provided also that where the total income, of the fund or trust or institution or any university or other educational institution or any

hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via), without giving effect to the provisions of the said sub-clauses, exceeds the maximum amount which is not chargeable to tax in any previous year, such trust or institution or any university or other educational institution or any hospital or other medical institution shall get its accounts audited in respect of that year by an accountant as defined in the *Explanation* below sub-section (2) of Section 288 and furnish along with the return of income for the relevant assessment year, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed;

Provided also that any amount of donation received by the fund or institution in terms of clause (d) of sub-section (2) of Section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, or which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilized in terms of sub-section (5C) of Section 80G and not transferred to the Prime Minister's National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

Provided also that where the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) does not apply its income during the year of receipt and accumulates it, any payment or credit out of such accumulation to any trust or institution registered under Section 12AA or to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or other medical institution, as the case may be, is established :

Provided also that where the fund or institution referred to in sub-clause (iv) or trust or institution referred to in sub-clause (v) is notified by the Central Government or is approved by the prescribed authority, as the case may be, or any university or other educational

institution referred to in sub-clause (v) or any hospital or other medical institution referred to in sub-clause (via), is approved by the prescribed authority and subsequently that Government or the prescribed authority is satisfied that—

- (i) such fund or institution or trust or any university or other educational institution or any hospital or other medical institution has not—
  - (A) applied its income in accordance with the provisions contained in clause (a) of the third proviso; or
  - (B) invested or deposited its funds in accordance with the provisions contained in clause (b) of the third proviso; or
- (ii) the activities of such fund or institution or trust or any university or other educational institution or any hospital or other medical institution—
  - (A) are not genuine; or
  - (B) are not being carried out in accordance with all or any of the conditions subject to which it was notified or approved,

it may, at any time after giving a reasonable opportunity of showing cause against the proposed action to the concerned fund or institution or trust or any university or other educational institution or any hospital or other medical institution, rescind the notification or, by order, withdraw the approval, as the case may be, and forward a copy of the order rescinding the notification or withdrawing the approval to such fund or institution or trust or any university or other educational institution or any hospital or other medical institution and to the Assessing Officer;

Provided also that in case the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in the first proviso makes an application on or after the 1st day of June, 2006 for the purposes of grant of exemption or continuance thereof, such application shall be made on or before the 30th day of September of the relevant assessment year from which the exemption is sought;

Provided also that any anonymous donation referred to in Section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income;

Provided also that all pending applications, on which no notification has been issued under sub-clause (iv) or sub-clause (v) before the 1st day of June, 2007, shall stand transferred on that day to the prescribed authority and the prescribed authority may proceed with such applications under those sub-clauses from the stage at which they were on that day."

### **Income from property held for charitable or religious purposes**

11. (1) Subject to the provisions of Section 60 to 63, the following income shall not be included in the total income of the previous year of the person in receipt of the income—

- (a) income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of fifteen per cent of the income from such property;
- (b) income derived from property held under trust in part only for such purposes, the trust having been created before the commencement of this Act, to the extent to which such income is applied to such purposes in India; and, where any such income is finally set apart for application to such purposes in India, to the extent to which the income so set apart is not in excess of fifteen per cent of the income from such property;
- (c) income derived from property held under trust—
  - (i) created on or after the 1st day of April, 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and
  - (ii) for charitable or religious purposes, created before the 1st day of April, 1952, to the extent to which such income is applied to such purposes outside India:

Provided that the Board, by general or special order, has directed in either case that it shall not be included in the total income of the person in receipt of such income;

- (d) income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.]

*Explanation.*—For the purposes of clauses (a) and (b),—

- (1) in computing the fifteen per cent of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in Section 12 shall be deemed to be part of the income;
- (2) if, in the previous year, the income applied to charitable or religious purposes in India falls short of eighty-five per cent of the income derived during that year from property held under trust, or, as the case may be, held under trust in part, by any amount—
  - (i) for the reason that the whole or any part of the income has not been received during that year, or
  - (ii) for any other reason,

then—

- (a) in the case referred to in sub-clause (i), so much of the income applied to such purposes in India during the previous year in which the income is received or during the previous year immediately following as does not exceed the said amount, and
- (b) in the case referred to in sub-clause (ii), so much of the income applied to such purposes in India during the previous year immediately following the previous year in which the income was derived as does not exceed the said amount,

may, at the option of the person in receipt of the income (such option to be exercised in writing before the expiry of the time allowed under sub-section (1) of Section 139 for furnishing the return of income) be deemed to be income applied to such purposes during the previous year in which the income was derived; and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes, in the case referred to in sub-clause (i), during the previous year in which the income is received or during the previous year immediately following, as the case may be, and, in the case referred to in sub-clause (ii), during the previous year immediately following the previous year in which the income was derived.

(1A) For the purposes of sub-section (1),—

- (a) where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer

shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—

- (i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of such capital gain;
  - (ii) where only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gain as is equal to the amount, if any, by which the amount so utilised exceeds the cost of the transferred asset;
- (b) where a capital asset, being property held under trust in part only for such purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—
- (i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;
  - (ii) in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

*Explanation.*—In this sub-section,—

- (i) "appropriate fraction" means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes;
- (ii) "cost of the transferred asset" means the aggregate of the cost of acquisition (as ascertained for the purposes of Section 48 and 49) of the capital asset which is the subject of the transfer and the cost of any improvement thereto within the meaning assigned to that expression in sub-clause (b) of clause (1) of Section 55;
- (iii) "net consideration" means the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.]

(1B) Where any income in respect of which an option is exercised under clause (2) of the *Explanation* to sub-section (1) is not applied to charitable or religious purposes in India during the period referred to in sub-clause (a) or, as the case may be, sub-clause (b), of the said clause, then, such income shall be deemed to be the income of the person in receipt thereof—

- (a) in the case referred to in sub-clause (i) of the said clause, of the previous year immediately following the previous year in which the income was received; or
- (b) in the case referred to in sub-clause (ii) of the said clause, of the previous year immediately following the previous year in which the income was derived.

(2) Where eighty-five per cent of the income referred to in clause (a) or clause (b) of sub-section (1) read with the *Explanation* to that sub-section is not applied, or is not deemed to have been applied, to charitable or religious purposes in India during the previous year but is accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person in receipt of the income, provided the following conditions are complied with, namely:—

- (a) such person specifies, by notice in writing given to the Assessing Officer in the prescribed manner, the purpose for which the income is being accumulated or set apart and the period for which the income is to be accumulated or set apart, which shall in no case exceed ten years;
- (b) the money so accumulated or set apart is invested or deposited in the forms or modes specified in sub-section (5)

Provided that in computing the period of ten years referred to in clause (a), the period during which the income could not be applied for the purpose for which it is so accumulated or set apart, due to an order or injunction of any court, shall be excluded;

Provided further that in respect of any income accumulated or set apart on or after the 1st day of April, 2001, the provisions of this sub-section shall have effect as if for the words "ten years" at both the places where they occur, the words "five years" had been substituted.

*Explanation.*—Any amount credited or paid, out of income referred to in clause (a) or clause (b) of sub-section (1), read with the *Explanation* to that sub-section, which is not applied, but is accumulated or set apart, to any trust or institution registered under Section 12AA or to any fund or institution or

trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

- (3) Any income referred to in sub-section (2) which—
- (a) is applied to purposes other than charitable or religious purposes as aforesaid or ceases to be accumulated or set apart for application thereto, or
  - (b) ceases to remain invested or deposited in any of the forms or modes specified in sub-section (5), or
  - (c) is not utilised for the purpose for which it is so accumulated or set apart during the period referred to in clause (a) of that sub-section or in the year immediately following the expiry thereof,
  - (d) is credited or paid to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10,

shall be deemed to be the income of such person of the previous year in which it is so applied or ceases to be so accumulated or set apart or ceases to remain so invested or deposited or credited or paid or, as the case may be, of the previous year immediately following the expiry of the period aforesaid.

(3A) Notwithstanding anything contained in sub-section (3), where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in accordance with the provisions of clause (b) of sub-section (2) cannot be applied for the purpose for which it was accumulated or set apart, the Assessing Officer may, on an application made to him in this behalf, allow such person to apply such income for such other charitable or religious purpose in India as is specified in the application by such person and as is in conformity with the objects of the trust; and thereupon the provisions of sub-section (3) shall apply as if the purpose specified by such person in the application under this sub-section were a purpose specified in the notice given to the Assessing Officer under clause (a) of sub-section (2);

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of sub-section (3) of section 11;

Provided further that in case the trust or institution, which has invested or deposited its income in accordance with the provisions of clause (b) of sub-section (2), is dissolved, the Assessing Officer may allow application of such income for the purposes referred to in clause (d) of sub-section (3) in the year in which such trust or institution was dissolved.

(4) For the purposes of this section "property held under trust" includes a business undertaking so held, and where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of this Act relating to assessment; and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

(4A) Sub-section (1) or sub-section (2) or sub-section (3) or sub-section (3A) shall not apply in relation to any income of a trust or an institution, being profits and gains of business, 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.

(5) The forms and modes of investing or depositing the money referred to in clause (b) of sub-section (2) shall be the following, namely :—

- (i) investment in savings certificates as defined in clause (c) of section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government;
- (ii) deposit in any account with the Post Office Savings Bank;
- (iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank).

*Explanation.*—In this clause, "scheduled bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank

constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

- (iv) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);
- (v) investment in any security for the money created and issued by the Central Government or a State Government;
- (vi) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;
- (vii) investment or deposit in any public sector company:  
 Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company,—
  - (A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;
  - (B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;
- (viii) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction under clause (viii) of sub-section (1) of Section 36];
- (ix) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes and which is eligible for deduction under clause (viii) of sub-section (1) of Section 36];
- (ixa) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the

business of providing long-term finance for urban infrastructure in India.

*Explanation.*—For the purposes of this clause,—

- (a) "long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;
  - (b) "public company" shall have the meaning assigned to it in section 3 of the Companies Act, 1956 (1 of 1956);
  - (c) "urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport;
- (x) investment in immovable property.
- Explanation.*—"Immovable property" does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;]
- (xi) deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964);]
- (xii) any other form or mode of investment or deposit as may be prescribed.

### **Income of trusts or institutions from contributions**

12. (1) Any voluntary contributions received by a trust created wholly for charitable or religious purposes or by an institution established wholly for such purposes (not being contributions made with a specific direction that they shall form part of the corpus of the trust or institution) shall for the purposes of Section 11 be deemed to be income derived from property held under trust wholly for charitable or religious purposes and the provisions of that section and Section 13 shall apply accordingly.

(2) The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any person referred to in clause (a) or clause (b) or clause (c) or clause (cc) or clause (d) of sub-section (3) of Section 13, shall be deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be

chargeable to income-tax notwithstanding the provisions of sub-section (1) of Section 11.

*Explanation.*—For the purposes of this sub-section, the expression "value" shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person referred to in clause (a) or clause (b) or clause (c) or clause (cc) or clause (d) of sub-section (3) of Section 13.

(3) Notwithstanding anything contained in Section 11, any amount of donation received by the trust or institution in terms of clause (d) of sub-section (2) of Section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, or] which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilized in terms of sub-section (5C) of Section 80G and not transferred to the Prime Minister's National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

### **Conditions for applicability of Sections 11 and 12.**

**12A.** (1) The provisions of Section 11 and Section 12 shall not apply in relation to the income of any trust or institution unless the following conditions are fulfilled, namely:—

(a) the person in receipt of the income has made an application for registration of the trust or institution in the prescribed form and in the prescribed manner to the Commissioner before the 1st day of July, 1973, or before the expiry of a period of one year from the date of the creation of the trust or the establishment of the institution, whichever is later and such trust or institution is registered under Section 12AA;

**Provided** that where an application for registration of the trust or institution is made after the expiry of the period aforesaid, the provisions of Section 11 and 12 shall apply in relation to the income of such trust or institution,—

- (i) from the date of the creation of the trust or the establishment of the institution if the Commissioner is, for reasons to be recorded in writing, satisfied that the person in receipt of the income was prevented from making the application before the expiry of the period aforesaid for sufficient reasons;
- (ii) from the 1st day of the financial year in which the application is made, if the Commissioner is not so satisfied;

**Provided further** that the provisions of this clause shall not apply in relation to any application made on or after the 1st day of June, 2007;

(aa) the person in receipt of the income has made an application for registration of the trust or institution on or after the 1st day of June, 2007 in the prescribed form and manner to the Commissioner and such trust or institution is registered under Section 12AA;

(b) where the total income of the trust or institution as computed under this Act without giving effect to the provisions of Section 11 and Section 12 exceeds the maximum amount which is not chargeable to income tax in any previous year, the accounts of the trust or institution for that year have been audited by an accountant as defined in the *Explanation* below sub-section (2) of Section 288 and the person in receipt of the income furnishes along with the return of income for the relevant assessment year the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed.

(2) Where an application has been made on or after the 1st day of June, 2007, the provisions of Section 11 and 12 shall apply in relation to the income of such trust or institution from the assessment year immediately following the financial year in which such application is made.

### **Procedure for registration**

**12AA** (1) The Commissioner, on receipt of an application for registration of a trust or institution made under clause (a) or clause (aa) of sub-section (1) of Section 12A, shall—

(a) call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf; and

(b) after satisfying himself about the objects of the trust or institution and the genuineness of its activities, he—

(i) shall pass an order in writing registering the trust or institution;

(ii) shall, if he is not so satisfied, pass an order in writing refusing to register the trust or institution,

and a copy of such order shall be sent to the applicant :

**Provided** that no order under sub-clause (ii) shall be passed unless the applicant has been given a reasonable opportunity of being heard.

(1A) All applications, pending before the Chief Commissioner on which no order has been passed under clause (b) of sub-section (1) before the 1st day of June, 1999, shall stand transferred on that day to the Commissioner and the Commissioner may proceed with such applications under that sub-section from the stage at which they were on that day.

(2) Every order granting or refusing registration under clause (b) of sub-section (1) shall be passed before the expiry of six months from the end of the month in which the application was received under clause (a) or clause (aa) of sub-section (1)] of Section 12A.

(3) Where a trust or an institution has been granted registration under clause (b) of sub-section (1) or has obtained registration at any time under Section 12A as it stood before its amendment by the Finance (No. 2) Act, 1996 (33 of 1996) and subsequently the Commissioner is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, he shall pass an order in writing cancelling the registration of such trust or institution:

Provided that no order under this sub-section shall be passed unless such trust or institution has been given a reasonable opportunity of being heard.

### **Section 11 not to apply in certain cases**

13 (1) Nothing contained in Section 11 or Section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof—

- (a) any part of the income from the property held under a trust for private religious purposes which does not inure for the benefit of the public;
- (b) in the case of a trust for charitable purposes or a charitable institution created or established after the commencement of this Act, any income thereof if the trust or institution is created or established for the benefit of any particular religious community or caste;
- (c) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof—
  - (i) if such trust or institution has been created or established after the commencement of this Act and under the terms of the trust or the rules governing the institution, any part of such income inures, or

- (i) if any part of such income or any property of the trust or the institution (whenever created or established) is during the previous year used or applied,

directly or indirectly for the benefit of any person referred to in sub-section (3) :

Provided that in the case of a trust or institution created or established before the commencement of this Act, the provisions of sub-clause (i) shall not apply to any use or application, whether directly or indirectly, of any part of such income or any property of the trust or institution for the benefit of any person referred to in sub-section (3), if such use or application is by way of compliance with a mandatory term of the trust or a mandatory rule governing the institution:

Provided further that in the case of a trust for religious purposes or a religious institution (whenever created or established) or a trust for charitable purposes or a charitable institution created or established before the commencement of this Act, the provisions of sub-clause (i) shall not apply to any use or application, whether directly or indirectly, of any part of such income or any property of the trust or institution for the benefit of any person referred to in sub-section (3) in so far as such use or application relates to any period before the 1st day of June, 1970;

- (d) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof, if for any period during the previous year—
  - (i) any funds of the trust or institution are invested or deposited after the 28th day of February, 1983 otherwise than in any one or more of the forms or modes specified in sub-section (5) of Section 11; or
  - (ii) any funds of the trust or institution invested or deposited before the 1st day of March, 1983 otherwise than in any one or more of the forms or modes specified in sub-section (5) of Section 11 continue to remain so invested or deposited after the 30th day of November, 1983; or
  - (iii) any shares in a company, other than—
    - (A) shares in a public sector company ;
    - (B) shares prescribed as a form or mode of investment under clause (xii) of sub-section (5) of Section 11, are

held by the trust or institution after the 30th day of November, 1983:

Provided that nothing in this clause shall apply in relation to—

- (i) any assets held by the trust or institution where such assets form part of the corpus of the trust or institution as on the 1st day of June, 1973;
- (ia) any accretion to the shares, forming part of the corpus mentioned in clause (i), by way of bonus shares allotted to the trust or institution;
- (ii) any assets (being debentures issued by, or on behalf of, any company or corporation) acquired by the trust or institution before the 1st day of March, 1983;
- (iia) any asset, not being an investment or deposit in any of the forms or modes specified in sub-section (5) of Section 11, where such asset is not held by the trust or institution, otherwise than in any of the forms or modes specified in sub-section (5) of Section 11, after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st day of March, 1993, whichever is later;
- (iii) any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year commencing on the 1st day of April, 1984 or any subsequent assessment year.

*Explanation.*—Where the trust or institution has any other income in addition to profits and gains of business, the provisions of clause (iii) of this proviso shall not apply unless the trust or institution maintains separate books of account in respect of such business.

*Explanation.*—For the purposes of sub-clause (ii) of clause (c), in determining whether any part of the income or any property of any trust or institution is during the previous year used or applied, directly or indirectly, for the benefit of any person referred to in sub-section (3), in so far as such use or application relates to any period before the 1st day of July, 1972, no regard shall be had to the amendments made to this section by Section 7 other than sub-clause (i) of clause (a) thereof of the Finance Act, 1972.

- (2) Without prejudice to the generality of the provisions of clause (c) and clause (d) of sub-section (1), the income or the property of the trust or institution or any part of such income or property shall, for the purposes of

that clause, be deemed to have been used or applied for the benefit of a person referred to in sub-section (3),—

- (a) if any part of the income or property of the trust or institution is, or continues to be, lent to any person referred to in sub-section (3) for any period during the previous year without either adequate security or adequate interest or both;
- (b) if any land, building or other property of the trust or institution is, or continues to be, made available for the use of any person referred to in sub-section (3), for any period during the previous year without charging adequate rent or other compensation;
- (c) if any amount is paid by way of salary, allowance or otherwise during the previous year to any person referred to in sub-section (3) out of the resources of the trust or institution for services rendered by that person to such trust or institution and the amount so paid is in excess of what may be reasonably paid for such services;
- (d) if the services of the trust or institution are made available to any person referred to in sub-section (3) during the previous year without adequate remuneration or other compensation;
- (e) if any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in sub-section (3) during the previous year for consideration which is more than adequate;
- (f) if any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in sub-section (3) during the previous year for consideration which is less than adequate;
- (g) if any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in sub-section (3):

Provided that this clause shall not apply where the income, or the value of the property or, as the case may be, the aggregate of the income and the value of the property, so diverted does not exceed one thousand rupees;

- (h) if any funds of the trust or institution are, or continue to remain, invested for any period during the previous year (not being a period before the 1st day of January, 1971), in any concern in which any person referred to in sub-section (3) has a substantial interest.

(3) The persons referred to in clause (c) of sub-section (1) and sub-section (2) are the following, namely :—

- (a) the author of the trust or the founder of the institution;
- (b) any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds fifty thousand rupees];
- (c) where such author, founder or person is a Hindu undivided family, a member of the family;
- (cc) any trustee of the trust or manager (by whatever name called) of the institution;
- (d) any relative of any such author, founder, person, member, trustee or manager as aforesaid;
- (e) any concern in which any of the persons referred to in clauses (a), (b), (c) (cc) and (d) has a substantial interest.

(4) Notwithstanding anything contained in clause (c) of sub-section (1) but without prejudice to the provisions contained in clause (d) of that sub-section, in a case where the aggregate of the funds of the trust or institution invested in a concern in which any person referred to in sub-section (3) has a substantial interest, does not exceed five per cent of the capital of that concern, the exemption under Section 11 or Section 12 shall not be denied in relation to any income other than the income arising to the trust or the institution from such investment, by reason only that the funds of the trust or the institution have been invested in a concern in which such person has a substantial interest.

[(5) Notwithstanding anything contained in clause (d) of sub-section (1), where any assets (being debentures issued by, or on behalf of, any company or corporation) are acquired by the trust or institution after the 28th day of February, 1983 but before the 25th day of July, 1991, the exemption under section 11 or section 12 shall not be denied in relation to any income other than the income arising to the trust or the institution from such assets, by reason only that the funds of the trust or the institution have been invested in such assets if such funds do not continue to remain so invested in such assets after the 31st day of March, 1992.]

(6) Notwithstanding anything contained in sub-section (1) or sub-section (2), but without prejudice to the provisions contained in sub-section (2) of Section 12, in the case of a charitable or religious trust running an educational institution or a medical institution or a hospital, the exemption under Section 11 or Section 12 shall not be denied in relation to any income,

other than the income referred to in sub-section (2) of Section 12 by reason only that such trust has provided educational or medical facilities to persons referred to in clause (a) or clause (b) or clause (c) or clause (cc) or clause (d) of sub-section (3).

(7) Nothing contained in Section 11 or Section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donation referred to in Section 115BBC on which tax is payable in accordance with the provisions of that section.

(8) Nothing contained in Section 11 or Section 12 shall operate so as to exclude any income from the total income of the previous year of the person in receipt thereof if the provisions of the first proviso to clause (15) of section 2 become applicable in the case of such person in the said previous year.

*Explanation 1.*—For the purposes of Section 11, 12, 12A and this section, "trust" includes any other legal obligation and for the purposes of this section "relative", in relation to an individual, means—

- (i) spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) any lineal ascendant or descendant of the individual;
- (v) any lineal ascendant or descendant of the spouse of the individual;
- (vi) spouse of a person referred to in sub-clause (ii), sub-clause (iii), sub-clause (iv) or sub-clause (v);
- (vii) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.]

*Explanation 2.*—A trust or institution created or established for the benefit of Scheduled Castes, Backward classes, Scheduled Tribes or women and children shall not be deemed to be a trust or institution created or established for the benefit of a religious community or caste within the meaning of clause (b) of sub-section (1).

*Explanation 3.*—For the purposes of this section, a person shall be deemed to have a substantial interest in a concern,—

- (i) in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of the voting power are, at any time during the previous year,

owned beneficially by such person or partly by such person and partly by one or more of the other persons referred to in sub-section (3);

- (/i) in the case of any other concern, if such person is entitled, or such person and one or more of the other persons referred to in sub-section (3) are entitled in the aggregate, at any time during the previous year, to not less than twenty per cent of the profits of such concern.

### **Special provision for computing deductions in the case of business reorganization of co-operative banks**

**44DB.** (1) The deduction under Section 32, Section 35D, Section 35DD or section 35DDA shall, in a case where business reorganization of a Co-operative bank has taken place during the financial year, be allowed in accordance with the provisions of this section.

(2) The amount of deduction allowable to the predecessor Co-operative bank under Section 32, Section 35D, Section 35DD or Section 35DDA shall be determined in accordance with the formula—

$$A \times \frac{B}{C}$$

where A = The amount of deduction allowable to the predecessor Co-operative bank if the business reorganization had not taken place;

B = The number of days comprised in the period beginning with the 1st day of the financial year and ending on the day immediately preceding the date of business reorganization; and

C = The total number of days in the financial year in which the business reorganization has taken place.

(3) The amount of deduction allowable to the successor Co-operative bank under Section 32, Section 35D, Section 35DD or Section 35DDA shall be determined in accordance with the formula—

$$A \times \frac{B}{C}$$

where A = the amount of deduction allowable to the predecessor co-operative bank if the business reorganization had not taken place;

- B = the number of days comprised in the period beginning with the date of business reorganization and ending on the last day of the financial year; and
- C = the total number of days in the financial year in which the business reorganization has taken place.

(4) The provisions of Section 35D, Section 35DD or Section 35DDA shall, in a case where an undertaking of the predecessor co-operative bank entitled to the deduction under the said section is transferred before the expiry of the period specified therein to a successor co-operative bank on account of business reorganization, apply to the successor co-operative bank in the financial years subsequent to the year of business reorganization as they would have applied to the predecessor co-operative bank, as if the business reorganization had not taken place.

### **Deduction in respect of income of Co-operative societies**

**80P.** (1) Where, in the case of an assessee being a Co-operative society, the gross total income includes any income referred to in sub-section (2), there shall be deducted, in accordance with and subject to the provisions of this section, the sums specified in sub-section (2), in computing the total income of the assessee.

(2) The sums referred to in sub-section (1) shall be the following, namely:—

- (a) in the case of a Co-operative society engaged in—
  - (i) carrying on the business of banking or providing credit facilities to its members, or
  - (ii) a cottage industry, or
  - (iii) the marketing of agricultural produce grown by its members, or
  - (iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members, or
  - (v) the processing, without the aid of power, of the agricultural produce of its members, or
  - (vi) the collective disposal of the labour of its members, or
  - (vii) fishing or allied activities, that is to say, the catching, curing, processing, preserving, storing or marketing of fish or the

purchase of materials and equipment in connection therewith for the purpose of supplying them to its members,

the whole of the amount of profits and gains of business attributable to any one or more of such activities:

Provided that in the case of a co-operative society falling under sub-clause (vi), or sub-clause (vii), the rules and bye-laws of the society restrict the voting rights to the following classes of its members, namely:—

- (1) the individuals who contribute their labour or, as the case may be, carry on the fishing or allied activities;
- (2) the Co-operative credit societies which provide financial assistance to the society;
- (3) the State Government;

(b) in the case of a Co-operative society, being a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to—

- (i) a federal Co-operative society, being a society engaged in the business of supplying milk, oilseeds, fruits, or vegetables, as the case may be; or
- (ii) the Government or a local authority; or
- (iii) a Government company as defined in section 617 of the Companies Act, 1956 (1 of 1956), or a corporation established by or under a Central, State or Provincial Act (being a company or corporation engaged in supplying milk, oilseeds, fruits or vegetables, as the case may be, to the public),

the whole of the amount of profits and gains of such business;

(c) in the case of a Co-operative society engaged in activities other than those specified in clause (a) or clause (b) (either independently of, or in addition to, all or any of the activities so specified), so much of its profits and gains attributable to such activities as does not exceed,—

- (i) where such Co-operative society is a consumers' co-operative society, one hundred thousand rupees; and
- (ii) in any other case, fifty thousand rupees.

*Explanation.*—In this clause, "consumers' Co-operative society" means a society for the benefit of the consumers;

- (d) in respect of any income by way of interest or dividends derived by the Co-operative society from its investments with any other co-operative society, the whole of such income;
- (e) in respect of any income derived by the Co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities, the whole of such income;
- (f) in the case of a Co-operative society, not being a housing society or an urban consumers' society or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power, where the gross total income does not exceed twenty thousand rupees, the amount of any income by way of interest on securities or any income from house property chargeable under Section 22.

*Explanation.*—For the purposes of this section, an "urban consumers' Co-operative society" means a society for the benefit of the consumers within the limits of a municipal corporation, municipality, municipal committee, notified area committee, town area or cantonment.

(3) In a case where the assessee is entitled also to the deduction under Section 80HH, or Section 80HHA or Section 80HHB or Section 80HHC or Section 80HHD or Section 80-I or Section 80-IA or Section 80J, the deduction under sub-section (1) of this section, in relation to the sums specified in clause (a) or clause (b) or clause (c) of sub-section (2), shall be allowed with reference to the income, if any, as referred to in those clauses included in the gross total income as reduced by the deductions under Section 80HH, Section 80HHA, Section 80HHB, Section 80HHC, Section 80HHD, or Section 80-I, Section 80-IA, Section 80J and Section 80JJ.

(4) The provisions of this section shall not apply in relation to any Co-operative bank other than a primary agricultural credit society or a primary Co-operative agricultural and rural development bank.

*Explanation.*—For the purposes of this sub-section,—

- (a) "Co-operative bank" and "primary agricultural credit society" shall have the meanings respectively assigned to them in Part V of the Banking Regulation Act, 1949 (10 of 1949);
- (b) "primary Co-operative agricultural and rural development bank" means a society having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

## Charge of tax where share of beneficiaries unknown

164 (1) Subject to the provisions of sub-sections (2) and (3), where any income in respect of which the persons mentioned in clauses (ii) and (iv) of sub-section (1) of Section 160 are liable as representative assesseees or any part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown (such income, such part of the income and such persons being hereafter in this section referred to as "relevant income", "part of relevant income" and "beneficiaries", respectively), tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate:

Provided that in a case where—

- (i) none of the beneficiaries has any other income chargeable under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust; or
- (ii) the relevant income or part of relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him; or
- (iii) the relevant income or part of relevant income is receivable under a trust created before the 1st day of March, 1970, by a non-testamentary instrument and the Assessing Officer is satisfied, having regard to all the circumstances existing at the relevant time, that the trust was created *bona fide* exclusively for the benefit of the relatives of the settlor, or where the settlor is a Hindu undivided family, exclusively for the benefit of the members of such family, in circumstances where such relatives or members were mainly dependent on the settlor for their support and maintenance; or
- (iv) the relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created *bona fide* by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession,

tax shall be charged on the relevant income or part of relevant income as if, it were the total income of an association of persons:

Provided further that where any income in respect of which the person mentioned in clause (iv) of sub-section (1) of Section 160 is liable as representative assessee consists of, or includes, profits and gains of

business, the preceding proviso shall apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him.

(2) In the case of relevant income which is derived from property held under trust wholly for charitable or religious purposes, or which is of the nature referred to in sub-clause (iia) of clause (24) of Section 2 or which is of the nature referred to in sub-section (4A) of Section 11, tax shall be charged on so much of the relevant income as is not exempt under Section 11 or Section 12, as if the relevant income not so exempt were the income of an association of persons :

Provided that in a case where the whole or any part of the relevant income is not exempt under Section 11 or Section 12 by virtue of the provisions contained in clause (c) or clause (d) of sub-section (1) of Section 13, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

(3) In a case where the relevant income is derived from the property held under trust in part only for charitable or religious purposes or is of the nature referred to in sub-clause (iia) of clause (24) of Section 2 or is of the nature referred to in sub-section (4A) of Section 11 and either the relevant income applicable to purposes other than charitable or religious purposes (or any part thereof) is not specifically receivable on behalf or for the benefit of any one person or the individual shares of the beneficiaries in the income so applicable are indeterminate or unknown, the tax chargeable on the relevant income shall be the aggregate of—

- (a) the tax which would be chargeable on that part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income, if any, which is exempt under Section 11 as if such part (or such part as so reduced) were the total income of an association of persons; and
- (b) the tax on that part of the relevant income which is applicable to purposes other than charitable or religious purposes, and which is either not specifically receivable on behalf or for the benefit of any one person or in respect of which the shares of the beneficiaries are indeterminate or unknown, at the maximum marginal rate:

Provided that in a case where—

- (i) none of the beneficiaries in respect of the part of the relevant income which is not applicable to charitable or religious purposes has any

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other income chargeable under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust; or

- (ii) the relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him; or
- (iii) the relevant income is receivable under a trust created before the 1st day of March, 1970, by a non-testamentary instrument and the Assessing Officer is satisfied, having regard to all the circumstances existing at the relevant time, that the trust, to the extent it is not for charitable or religious purposes, was created bona fide exclusively for the benefit of the relatives of the settlor, or where the settlor is a Hindu undivided family, exclusively for the benefit of the members of such family, in circumstances where such relatives or members were mainly dependent on the settlor for their support and maintenance,

tax shall be charged on the relevant income as if the relevant income (as reduced by the income, if any, which is exempt under Section 11) were the total income of an association of persons:

Provided further that where the relevant income consists of, or includes, profits and gains of business, the preceding proviso shall apply only if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him:

Provided also that in a case where the whole or any part of the relevant income is not exempt under Section 11 or Section 12 by virtue of the provisions contained in clause (c) or clause (d) of sub-section (1) of Section 13, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

*Explanation 1.*—For the purposes of this section,—

- (i) any income in respect of which the persons mentioned in clause (iii) and clause (iv) of sub-section (1) of Section 160 are liable as representative assessee or any part thereof shall be deemed as being not specifically receivable on behalf or for the benefit of any one person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed ;

- (i) the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is received shall be deemed to be indeterminate or unknown unless the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable, are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

### **Charge of tax in case of oral trust**

**164A.** Where a trustee receives or is entitled to receive any income on behalf or for the benefit of any person under an oral trust, then, notwithstanding anything contained in any other provision of this Act, tax shall be charged on such income at the maximum marginal rate.

*Explanation.*—For the purposes of this section,—

- (i) "oral trust" shall have the meaning assigned to it in *Explanation 2* below sub-section (1) of Section 160.

### **Case where part of trust income is chargeable**

**165.** Where part only of the income of a trust is chargeable under this Act, that proportion only of the income receivable by a beneficiary from the trust which the part so chargeable bears to the whole income of the trust shall be deemed to have been derived from that part.

### **Charge of tax where shares of members in association of persons or body of individuals unknown, etc.**

**167B.** (1) Where the individual shares of the members of an association of persons or body of individuals (other than a company or a co-operative society or a society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India) in the whole or any part of the income of such association or body are indeterminate or unknown, tax shall be charged on the total income of the association or body at the maximum marginal rate :

Provided that, where the total income of any member of such association or body is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on the total income of the association or body at such higher rate.

- (2) Where, in the case of an association of persons or body of individuals as aforesaid [not being a case falling under sub-section (1)],—

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- (i) the total income of any member thereof for the previous year (excluding his share from such association or body) exceeds the maximum amount which is not chargeable to tax in the case of that member under the Finance Act of the relevant year, tax shall be charged on the total income of the association or body at the maximum marginal rate;
- (ii) any member or members thereof is or are chargeable to tax at a rate or rates which is or are higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the association or body which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income of the association or body shall be taxed at the maximum marginal rate.

*Explanation.*—For the purposes of this section, the individual shares of the members of an association of persons or body of individuals in the whole or any part of the income of such association or body shall be deemed to be indeterminate or unknown if such shares (in relation to the whole or any part of such income) are indeterminate or unknown on the date of formation of such association or body or at any time thereafter.

### **Relief to certain charitable institutions or funds in respect of certain dividends**

**236A.** (1) Where seventy-five per cent of the share capital of any company is throughout the previous year beneficially held by an institution or fund established in India for a charitable purpose the income from dividend whereof is exempt under Section 11, credit shall be given to the institution or fund against the tax, if any, payable by it, of a sum calculated in accordance with the provisions of sub-section (2), in respect of its income from dividends (other than dividends on preference shares) declared or distributed during the previous year relevant to any assessment year beginning on or after the 1st day of April, 1966 by such a company, and where the amount of credit so calculated exceeds the tax, if any, payable by the said institution or fund, the excess shall be refunded.

(2) The amount to be given as credit under sub-section (1) shall be a sum which bears to the amount of the tax payable by the company under the provisions of the annual Finance Act with reference to the relevant amount of distributions of dividends by it the same proportion as the amount of the dividends (other than dividends on preference shares) received by the institution or fund from the company bears to the total amount of dividends

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(other than dividends on preference shares) declared or distributed by the company during the previous year.

*Explanation.*—In sub-section (2) of this section and in section 280ZB, the expression "the relevant amount of distributions of dividends" has the meaning assigned to it in the Finance Act of the relevant year.

## Appendix 2

# Circulars, Notifications, Forms under Income Tax Laws

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*Circular No. 584, dated 13-11-1990.*

Clarification regarding jurisdiction over assessment of trusts, funds, association and institutions claiming exemption under clauses (21), (22), (22A), (23), (23A) and (23C) of section 10, section 11 and section 12

1. The Central Board of Direct Taxes had issued a Notification SO No. 829(E), dated 17-10-1989 under section 120 of the Income-tax Act, 1961. Under the said notification, Directors of Income-tax (Exemptions) at Delhi, Bombay, Madras and Calcutta were assigned the functions of a Commissioner of Income-tax in respect of persons claiming exemptions under clauses (21), (22), (22A), (23), (23A) and (23C) of section 10, section 11 and section 12 of the Income-tax Act, 1961 and assessed or assessable by an income-tax authority having headquarters at Delhi, Bombay, Madras and Calcutta, respectively. A question has been raised as to whether applications for registration under section 12A(a) are to be made to the Directors of Income-tax (Exemptions) at the said four metropolitan cities or whether these should continue to be made to the respective Chief Commissioner/Commissioner of Income-tax.
2. *It is clarified that under the Notification SO No. 829(E), dated 17-10-1989, the respective Directors of Income-tax (Exemptions) at Delhi, Bombay, Madras and Calcutta have been assigned all the functions of a Commissioner of Income-tax in respect of the specified class of cases. Accordingly, wherever an application under any provision in the Income-tax Act including application for registration under section 12A(1), is to be made to the Commissioner of Income-tax, it should be made to the respective Director of Income-tax (Exemptions). This will only apply to cases where the assessee concerned is a person claiming exemption under any of the provisions mentioned above and was assessed by any income-tax authority having headquarters at four metropolitan cities of Delhi, Bombay, Calcutta and Madras.*

**Rule 2BC**

**Amount of annual receipts for the purposes of sub-clauses (iiid) and (iiie) of clause (23C) of section 10.**

**2BC.** (1) For the purposes of sub-clause ( *iiid* ) of clause ( *23C* ) of section 10, the amount of annual receipts on or after the 1st day of April, 1998, of any university or other educational institution, existing solely for educational purposes and not for purposes of profit, shall be one crores rupees.

(2) For the purposes of sub-clause ( *iiie* ) of clause ( *23C* ) of section 10, the amount of annual receipts on or after the 1st day of April, 1998, of any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit, shall be one crore rupees.

*SECTION 11 INCOME FROM PROPERTY HELD FOR CHARITY*

*Circular No. 100 [F. No. 195/1/72-IT(A-I)], dated 24-1-1973.*

**Repayment of debt incurred for purposes of trust/loans advanced by educational trusts to students for higher studies - Whether amounts to application of income**

1. Section 11 requires 100 per cent of the income of a charitable and religious trust to be applied for religious and charitable purposes to be entitled to the exemption under the said section. Two questions have been considered regarding the application of income:
  1. Where a trust incurs a debt for the purposes of the trust, whether the repayment of the debt would amount to an application of the income for the purposes of the trust ; and
  2. Whether loans advanced by an educational trust to students for higher studies would be treated as application of income for charitable purposes.
2. *The Board has decided that repayment of the loan originally taken to fulfill one of the objects of the trust will amount to an application of the income for charitable and religious purposes. As regards the loans advanced for higher studies, if the only object of the trust is to give interest-bearing loans for higher studies, it will amount to carrying on of money-lending business. If, however, the object of the trust is advancement of education and granting of scholarship loans as only one of the activities carried on for the fulfillment of the*

objectives of the trust, granting of loans, even if interest-bearing, will amount to the application of income for charitable purposes. As and when the loan is returned to the trust, it will be treated as income of that year.

### Judicial Analysis

*EXPLAINED IN* - In *CIT v. Cutchi Memon Union* [1985] 155 ITR 51 (Kar.): it was held that under the provisions of section 11, only the income spent on charitable or religious purposes is excluded from the total income of a trust. That exemption from taxation is given not because it is expenditure of the trust or any other outgoing. It is exempted as income to the extent applied for charitable or religious purposes. When that amount is returned by the beneficiaries of the trust, the receipt in the hands of the trust can only be its income of the years in which it is received. It cannot have any different character. This is also the tenor of the CBDT Circular No. 100, dated January 24, 1973.

*EXPLAINED IN* - In *CIT v. Ramchandra Poddar Charitable Trust* [1987] 164 ITR 666 (Cal.): the above circular was explained with the following observations:

"...An assessee may borrow money and spend it for a charitable object. The circular merely recognizes that in such a case, application of income for repayment of a loan taken for charitable purpose will amount to application of income for charitable purpose. The circular, however, does not permit an assessee to accumulate more than 25 per cent of its income or ₹ 10,000, whichever is higher (for the purpose of charity). The wording of section 11 is clear and unambiguous. The relief is limited to the amount of income of a charitable trust actually applied for charitable purpose. Accumulation of income is permitted only to the extent and subject to the conditions laid down in that section. An assessee can accumulate or set apart only 25 per cent of the income of the trust or ₹ 10,000, whichever is higher, in a given year. The circular does not seek to and cannot enlarge the scope of the section." (p. 673)

*EXPLAINED IN* - In *ITO v. K. Ravindranathan Nair* (1992) 41 ITD 462 (Coch.-Trib.): the Tribunal took aid of this Circular of the Board of Direct Taxes though it was in the context of section 11 only for the limited purposes of the treatment to be accorded to the loans and advances when given and the recovery of the same when received.

**Circular No. 273 [F. No. 180/57/80-IT(A-I)], dated 3-6-1980.**

184. Delay in filing application in Form No. 10 - Board's order under section 119(2)(b) authorizing Commissioner to admit belated applications

1. Charitable and religious trusts are entitled to exemption from income-tax under section 11 after they fulfill the requirements enumerated in sections 11 to 13. These trusts are allowed to accumulate or set apart the income derived by them from property held under trust provided they fulfill the conditions spelt out in section 11(2) read with rule 11 of the Income-tax Rules and Form No. 10.
2. Very often trusts are not able to file the application in Form No. 10 within the time allowed under section 139(1)/139(2) as extended by the Income-tax Officer. The Board is then approached by these trusts for condoning the delay for filing applications. The Board by virtue of the powers vested in it under section 119(2)(b) has been condoning the delay in individual cases after satisfying itself that certain conditions are satisfied.
3. With a view to expediting the disposal of applications filed by trusts for condoning the delay, the Board has passed a general order under section 119(2)(b) by which the Commissioners have been authorized to admit belated applications under section 11(2) read with rule 17. A copy of this order is enclosed. All applications for condoning the delay under section 11(2) will, henceforth, be disposed of by the Commissioner in terms of the enclosed Order No. 120/57/80-IT(A-I), dated 3-6-1980 [*Annex*].

**ANNEX - ORDER DATED 3-6-1980 REFERRED TO IN CLARIFICATION**

In exercise of the powers conferred under section 119(2)(b) of the Income-tax Act, 1961 (43 of 1961), the Central Board of Direct Taxes hereby authorize the Commissioners to admit applications under section 11(2) read with rule 17 of the Income-tax Rules, 1962 from persons deriving income from the property held under trust wholly for charitable or religious purposes for accumulation of such income to be applied for such purposes in India when the aforementioned applications are filed beyond the time stipulated. The Commissioners will, while entertaining such applications, satisfy themselves that the following conditions are fulfilled:

- (a) that the genuineness of the trust is not in doubt;
- (b) that the failure to give notice to the Income-tax Officer under section 11(2) of the Act and investment of the money in the prescribed securities was due only to oversight;

- (c) that the trustees or the settlor have not been benefited by such failure directly or indirectly;
- (d) that the trust agrees to deposit its funds in the prescribed securities prior to the issue of the Government sanction extending the time under section 11(2); and
- (e) that the accumulation or setting apart of income was necessary for carrying out the objects of the trust.

### Judicial Analysis

*APPLIED IN* - The above circular was applied in *CIT v. Anjuman Moinia Fakharia* [1994] 208 ITR 568 (Raj.), with the following observations:

"From the circular issued by the Department dated June 3, 1980, and the judgment of the Apex Court referred to above, it can be considered that the requirement to prescribe (*sic*) the time-limit is only directory and not mandatory. Non-compliance within the stipulated time should not disentitle an assessee from the exemption to which he is otherwise entitled...." (p. 572)

*EXPLAINED IN* - *Gujarat Institute of Desert Ecology v. CIT* [2003] 131 Taxman 274 (Guj.) with the following observations:

"Very often trusts are not able to file the application under section 11(1)/(2) of the Act within time limit allowed by the provisions and thereafter the trusts are required to approach the Board for condoning the delay in filing application. With a view to expedite the disposal of application filed by the trusts for condoning the delay, the Board has passed a general order under section 119(2)(b) by which the Commissioners of Income-tax have been authorized to admit belated application under section 11(2), read with rule 17 of the Income-tax Rules, 1962. Accordingly, all the Commissioners of Income-tax were instructed to dispose of all the applications for condoning delay under section 11(2) in terms of the order dated 3-6-1980."

### *Circular No. 52 [F. No. 152(55) 70-TPL], dated 30-12-1970.*

Capital gain arising to charitable trust - Whether it could be regarded as having been applied to charitable purposes if trust invests the amount received from sale of capital asset in acquiring another capital asset for trust - Section 11(1) as amended by the Finance Act, 1970.

Under section 11(1), as amended by the Finance Act, 1970, the income derived from property held under trust for charitable or religious purposes is exempt from income-tax only to the extent such income is actually applied to such purposes during the previous year itself or within three months next following. As "income" includes "capital gains" a charitable or religious trust

will forfeit exemption from income-tax in respect of its income by way of capital gains unless such income is also applied to the purposes of the trust during the period referred to above. In this connection, a question has been raised whether the capital gains arising to a charitable or religious trust from the sale of capital assets belonging to it would be regarded as having been applied to charitable or religious purposes, if the trust invests the amount received from the sale of the capital asset, including the capital gains realized, in acquiring another capital asset for the trust. This question was earlier examined by the Board in 1963 and instructions were issued *vide* Circular No. 2-P(LXX-5), dated 15-5-1963 [Annex] to the effect that *where a charitable or religious trust transfers a capital asset forming part of the corpus of its property solely with a view to acquiring another capital asset for the use and benefit of the trust, and utilizes the capital gains arising from the transaction in acquiring the new capital asset, the amount of capital gains so utilised would be regarded as having been applied to the charitable or religious purposes of the trust within the meaning of section 11(1). The Board have decided that the above instructions should continue to be operative notwithstanding the changes made in the scheme of tax exemption of charitable or religious trusts through the Finance Act, 1970.*

ANNEX - CIRCULAR, DATED 15-5-1963 REFERRED TO IN CLARIFICATION

1. Under section 11(1), a religious or charitable trust which accumulates its income in excess of 25 per cent of its total income or ₹ 10,000, whichever is higher, is liable to pay tax on the income accumulated by it in excess of the said limit. In other words, such a trust has to apply at least 75 per cent of its total income, including any capital gains forming part of it during the relevant previous year, in order to be entitled to exemption on the entire amount of its income. In this connection, a question was raised during the third meeting on the Direct Taxes Advisory Committee whether the capital gains arising to a trust from the sale of a capital asset belonging to it would be regarded as having been applied for the purposes of the trust, if the trust invested the amount received from the sale of the capital asset, including the capital gains realized, in acquiring another capital asset for the trust. This point has been considered and it has been decided that *where a religious or charitable trust transfers a capital asset forming part of the corpus of its property solely with a view to acquiring another capital asset for the use and benefit of the trust and utilizes the capital gains arising from the transaction in acquiring the new capital asset, the amount of capital gain so utilised should be*

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*regarded as having been applied for the religious or charitable purposes of the trust within the meaning of section 11(1).*

2. Under sub-section (2) of section 11, a trust, which desires to accumulate its income in excess of the limit specified in sub-section (1) for subsequent application to the purposes of the trust, is entitled to do so on giving a notice to the Income-tax Officer in this behalf in the prescribed form and investing the money so accumulated in certain securities of the Government. Under rule 17 of the Income-tax Rules, 1962, the notice of accumulation is required to be given in Form No. 10 of the Income-tax Rules, 1962. According to para 2 of this Form, the accumulated money has to be invested in specified securities before the expiry of one month commencing from the end of the relevant previous year and, according to para 3 to the Form, copies of the annual accounts of the trust along with details of investment and utilization, if any, of the money so accumulated or set apart, have to be furnished to the Income-tax Officer before April 30 every year. It was pointed out during the third meeting of the Direct Taxes Advisory Committee that it may not always be possible for the trustees to ascertain the income of the trust within one month of the end of the previous year and they may not, therefore, be able to comply with the requirements referred to above. In respect of the assessment year 1962-63, instructions were issued in the *Board's Circular No. 17(LXX-4), dated 2-6-1962* [Clarification 6 to Sl. No. 186 on p. 571 *post*] that the first requirement should be regarded as having been fulfilled if the accumulated money were invested in the specified securities before September 30, 1962, and similarly the second requirement should be regarded as having been fulfilled if copies of the relevant accounts along with details of investment and utilization of the accumulated money were furnished to the Income-tax Officer concerned before September 30, 1962. Having regard to the difficulty mentioned above, *it has now been decided that in respect of subsequent assessment years, trustees should be allowed to invest the accumulated income in specified securities within an extended period of four months commencing from the end of the relevant previous year. Similarly, with regard to the second requirement of furnishing copies of accounts, etc., it has been decided that trustees may be allowed to do so within a period of four months from the end of the relevant previous year or before April 30 of the assessment year, whichever is later.*

**Letter No. 12/113/68-IT (A-II), dated 28-10-1968.**

Whether tax is to be deducted at source from interest payable to educational institution/charitable trust whose income is exempt under section 10(22) and under section 11, respectively

I am directed to refer to letter dated 8-8-1968 [printed here as *Annex*] on the subject quoted above and to say that so far as an educational institution *whose income is exempt from tax under section 10(22) is concerned the provision of section 194A will not apply to it* and no deduction of tax at source from interest is required to be made by the payers. *As regards a charitable trust* whose income is exempt under section 11, a statement in writing may be made by the institution concerned under section 194A, or the institution may apply for a certificate for deduction at a lower rate or for authorization of non-deduction at source under section 197.

**ANNEX - LETTER, DATED 8-8-1968 REFERRED TO IN CLARIFICATION**

On reading your Circular No. 22/68-IT(B), dated 28-3-1968 addressed to all State Governments on the point of deduction of tax at source out of interest other than "interest on securities" in accordance with the provisions of section 194A, it appears to me that an educational institution whose income may be exempt under section 10(22) or a public charitable trust enjoying exemption under section 11 can also issue a statement in writing in Form No. 15A for receiving interest without deduction of tax at source. This is because the educational institution or the public charitable trust, as the case may be, does not have any income liable to income-tax. The total income may be more than ₹ 4,000 but that is exempt under section 11 or under section 10(22). Kindly clarify the position and oblige.

**Circular No. 566, dated 17-7-1990.**

**189. Clarification regarding investment in 'Kisan Vikas Patra' and 'Indira Vikas Patra'**

1. Sub-section (5) of section 11 of the Income-tax Act, 1961 specifies the forms and modes of investment or deposit or surplus money by public charitable or religious trusts and institutions as referred to in section 11(2)(b) of the Act. Clause (j) of the said sub-section (5) specifies one of the forms of investment as investment in savings certificates as defined in clause (c) of section 2 of the Government Savings Certificates Act, 1959, and any other securities or certificates issued by the Central Government under the Small Savings Scheme.
2. Representations have been received seeking clarification whether investments in 'Indira Vikas Patra' and 'Kisan Vikas Patra' are

covered by the form or mode of investment specified in the aforesaid clause (j) of sub-section (5) of section 11.

3. Section 2(c) of the Government Savings Certificates Act, 1959, defines 'savings certificates' as certificates to which that Act applies. Section 12 of the said Act empowers the Central Government to make rules to carry out the purposes of that Act. The Indira Vikas Patra Rules, 1986, and the Kisan Vikas Patra Rules, 1988, have been notified by the Central Government in exercise of the powers conferred by the aforesaid section 12 of the Government Savings Certificates Act, 1959. Thus, both these Patras are savings certificates to which the aforesaid Government Savings Certificates Act, 1959 applies. These are, therefore, covered by section 11(5)(i) of the Income-tax Act read with section 2(c) of the Government Savings Certificates Act.
4. It is, therefore, clarified that *the investments in 'Indira Vikas Patra' and 'Kisan Vikas Patra' are in accordance with the norms and modes specified in section 11(5) of the Income-tax Act.*

**Circular No. 584, dated 13-11-1990.**

**137. Clarification regarding jurisdiction over assessment of trusts, funds, association and institutions claiming exemption under clauses (21), (22), (22A), (23), (23A) and (23C) of section 10, section 11 and section 12**

1. The Central Board of Direct Taxes had issued a Notification SO No. 829(E), dated 17-10-1989 under section 120 of the Income-tax Act, 1961. Under the said notification, Directors of Income-tax (Exemptions) at Delhi, Bombay, Madras and Calcutta were assigned the functions of a Commissioner of Income-tax in respect of persons claiming exemptions under clauses (21), (22), (22A), (23), (23A) and (23C) of section 10, section 11 and section 12 of the Income-tax Act, 1961 and assessed or assessable by an income-tax authority having headquarters at Delhi, Bombay, Madras and Calcutta, respectively. A question has been raised as to whether applications for registration under section 12A(a) are to be made to the Directors of Income-tax (Exemptions) at the said four metropolitan cities or whether these should continue to be made to the respective Chief Commissioner/Commissioner of Income-tax.
2. *It is clarified that under the Notification SO No. 829(E), dated 17-10-1989, the respective Directors of Income-tax (Exemptions) at Delhi, Bombay, Madras and Calcutta have been assigned all the functions*

*of a Commissioner of Income-tax in respect of the specified class of cases. Accordingly, wherever an application under any provision in the Income-tax Act including application for registration under section 12A(1), is to be made to the Commissioner of Income-tax, it should be made to the respective Director of Income-tax (Exemptions). This will only apply to cases where the assessee concerned is a person claiming exemption under any of the provisions mentioned above and was assessed by any income-tax authority having headquarters at four metropolitan cities of Delhi, Bombay, Calcutta and Madras.*

**CBDT Instruction No. 1132, dated 5-1-1978. [Extracted from CIT v. Sarladevi Sarabhai Trust (No. 2) [1988] 172 ITR 698 (Guj.), at p. 709].**

#### **SECTION 13- DENIAL OF EXEMPTION**

##### **Availability of exemption in hands of charitable trusts of amounts paid as donation to other charitable trusts**

A question has been raised regarding the availability of exemption in the hands of charitable trusts of amounts paid as a donation to other charitable trusts.

The issue has been considered by the Board and it has been decided that as the law stands at present, the *payment of a sum by one charitable trust to another for utilization by the donee trust towards its charitable objects is proper application of income for charitable purpose in the hands of the donee trust*; and the donor trust will not lose exemption under section 11 of the Income-tax Act, 1961, merely because the donee trust did not spend the donation during the year of receipt itself.

The above position may kindly be brought to the notice of all officers working in your charge.

**Circular No. 335[F. No. 180/9/81-IT (A-I)], dated 13-4-1982.**

##### **194. Requirements in sections 11(1)(a) and 13(1)(d) to be complied with before exemption can be availed under section 11**

1. Section 11(1)(a) provides for the grant of exemption from income-tax to the income derived from property held under trust for charitable or religious purposes to the extent the income is applied for such purposes in India. Where any such income is accumulated or set apart for application to such purposes in India the extent to which the income is permitted to be accumulated or set apart is 25 per cent of the income. Therefore, under section 11(1)(a) the income derived from property held under trust enjoys exemption when at least 75 per cent of the income is applied for charitable or religious purposes.

2. Section 13(1) (d) was introduced by the Taxation Laws (Amendment) Act, 1975. It provides for denial of exemption under section 11 for any assessment year commencing from 1982-83 if any funds of the trust or institution are invested or deposited or continue to remain invested or deposited for any period during any previous year commencing on or after April 1, 1981 in any form or mode other than those specified in section 13(5). The Finance Bill, 1982 contains a provision to extend this period to one year so that the requirements will be applicable from the assessment year 1983-84 for the previous year commencing on or after April 1, 1982.
3. The effect of the insertion of section 13(1)(d) or section 11(1)(a) has been examined. The exemption under section 11(1)(a) will be available only if at least 75 per cent of the income is applied for charitable or religious purposes in India during the year and the remaining amount is invested in the forms or modes specified under section 13(5). *Thus, both the requirements will have to be fulfilled before the trust can claim and avail of the exemption under section 11(1)(a).*

*An example to illustrate the position is given below:*

A trust derives the income from property held for charitable purposes to the extent of ₹ 40,000 in a year. Under section 11(1)(a) it has to spend at least ₹ 30,000 on charitable purpose. The balance of ₹ 10,000 will have to be invested in the forms or modes prescribed under section 13(5). It is only then that the entire income of the trust will get exemption under section 11(1) (a).

4. It may, however, be clarified that *in regard to the accumulation of income permitted under section 11(2), the provisions of section 13(6) make it clear that the requirements of section 13(1)(d) read with section 13(5) will not apply.* This is because the mode of investing moneys allowed to be accumulated under section 11(2) is specified in that section itself.

### **Rule 17**

**Notice for accumulation of income by charitable or religious trust or institution or association referred to in clauses (21) and (23) of section 10.**

17. The notice to be given to the Assessing Officer or the prescribed authority under sub-section (2) of section 11 or under the said provision as applicable under clause (21) or clause (23) of section 10 shall be in Form No.

10 and shall be delivered before the expiry of the time allowed under subsection (1) of section 139, for furnishing the return of income.

**FORM NO.10** [See rule 17]

**Notice to the Assessing Officer/Prescribed Authority under section 11(2) of the Income tax Act, 1961**

To

The Assessing Officer/Prescribed Authority,

1. I,....., on behalf of..... [*name of the trust/institution/association*] hereby bring to your notice that it has been decided by a resolution passed by the trustees/governing body, by whatever name called, on (copy enclosed) that, out of the income of the trust/institution/association for the previous year(s), relevant to the assessment year and subsequent previous year(s), an amount of ₹ per cent of the income of the trust/institution/association, such sum as is available at the end of the previous year(s) should be accumulated or set apart till the previous year(s) ending in order to enable the trustees/governing body by whatever name called, to accumulate sufficient funds for carrying out the following purposes of the trust/association/institution :
  2. Before expiry of six months commencing from the end of each previous year, the amount so accumulated or set apart has been/will be invested or deposited in any one or more of the forms or modes specified in subsection (5) of section 11.
  3. Copies of the annual accounts of the trust/institution/association along with details of investment (including deposits) and utilization, if any, of the money so accumulated or set apart will be furnished to you before the expiry of six months commencing from the end of each relevant previous year.
  4. It is requested that in view of our complying with the conditions laid down in section 11(2) of the income-tax Act, 1961, the benefit of that section may be given in the assessments of the trust exempting the income in respect of the trust/institution/association in respect of the income accumulated or set apart as mentioned above.

Date:

*Signature*

*Designation*

*Address*

**Notes:**

1. This notice should be signed by a trustee/principal officer.
2. Delete the inappropriate words.

**Rule 17C**

**Forms or modes of investment or deposits by a charitable or religious trust or institution.**

**17C.** The forms and modes of investment or deposits under clause (xi) of sub-section (5) of section 11 shall be the following, namely :—

- (i) investment in the units issued under any scheme of the mutual fund referred to in clause (23D) of section 10 of the Income-tax Act, 1961;
- (ii) any transfer of deposits to the Public Account of India;
- (iii) deposits made with an authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages, or for both;
- (iv) investment by way of acquiring equity shares of a depository as defined in clause (e) of sub-section (1) of section 2 of the Depositories Act, 1996 (22 of 1996);]
- (v) investment made by a recognized stock exchange referred to in clause (A) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) (hereafter referred to as investor) in the equity share capital of a company (hereafter referred to as investee)—
  - (A) which is engaged in dealing with securities or mainly associated with the securities market;
  - (B) whose main object is to acquire the membership of another recognized stock exchange for the sole purpose of facilitating the members of the investor to trade on the said stock exchange through the investee in accordance with the directions or guidelines issued under the Securities and Exchange Board of India Act, 1992 (15 of 1992) by the Securities and Exchange Board of India established under section 3 of that Act; and

- (C) in which at least fifty-one per cent of equity shares are held by the investor and the balance equity shares are held by members of such investor;
- (vi) investment by way of acquiring equity shares of an incubatee by an incubator.

*Explanation.*— For the purposes of this clause,—

- (a) "incubatee" shall mean such incubatee as may be notified by the Government of India in the Ministry of Science and Technology;
  - (b) "incubator" shall mean such Technology Business Incubator or Science and Technology Entrepreneurship Park as may be notified by the Government of India in the Ministry of Science and Technology;]
- (vii) investment by way of acquiring shares of National Skill Development Corporation.

**Circular No. 143 [F. No. 180/74/73-IT (A-I)], dated 20-8-1974.**

**Audit report in Form No. 10B in terms of rule 17B - Auditor can accept as a correct list of specified persons as given by managing trustee while filing report**

1. Under section 12A(b), in the cases of charitable and religious trusts or institutions whose total income, without giving effect to the provisions of sections 11 and 12, exceeds 25,000 rupees in any previous year, the accounts of the trust or institution should have been audited by an accountant as defined in the *Explanation* below section 288(2) and the person in receipt of the income should furnish, along with the return of income for the relevant assessment year, the report of such audit in the prescribed form duly signed and verified by such authority and setting forth such particulars as may be prescribed. Rule 17B of the Income-tax Rules, 1962 lays down that the report of audit of accounts of the trust of the institution should be in Form No. 10B. The Annexure to Form No. 10B requires the auditor to certify, *inter alia*, as to the non-application or non-user of the income or property for the benefit of persons referred to in section 13(3).
2. The Board has considered a representation that *while filing Form No. 10B and its annexure an auditor can accept as correct the list of persons covered by section 13(3), as given by the managing trustees, etc. The Board agree that an auditor can accept as correct the list of*

*specified persons, till* given further instructions, by the managing trustees and base their report on the strength of this certificate.

**Application for registration of charitable or religious trusts, etc.**

**Rule 17A**

**17A.** An application under [clause (aa) of sub-section (1)] of section 12A for registration of a charitable or religious trust or institution shall be made in duplicate in Form No. 10A and shall be accompanied by the following documents, namely :—

- (a) where the trust is created, or the institution is established, under an instrument, the instrument in original, together with one copy thereof; and where the trust is created, or the institution is established, otherwise than under an instrument, the document evidencing the creation of the trust or the establishment of the institution, together with one copy thereof :

Provided that if the instrument or document in original cannot conveniently be produced, it shall be open to the Commissioner to accept a certified copy in lieu of the original;

- (b) where the trust or institution has been in existence during any year or years, prior to the financial year in which the application for registration is made, two copies of the accounts of the trust or institution relating to such prior year or years (not being more than three years immediately preceding the year in which the said application is made) for which such accounts have been made up.

**FORM NO. 10A [See rule 17A]**

**Application for registration of charitable or religious trust or institution under clause (aa) of sub-section (1) of section 12A of the Income-tax Act, 1961**

To

The Commissioner of Income-tax,

Sir,

I ....., on behalf of [name of the trust or institution] hereby apply for the registration of the said trust/institution under section 12A of the Income-tax Act, 1961. The following particulars are furnished herewith:

1. Name of the \* trust/institution in full [in block letters]

2. Address
3. Name(s) and address(es) of author(s)/founder(s)
4. Date of creation of the trust or establishment of the institution
5. Name(s) and address(es) of trustee(s)/manager(s)

I also enclose the following documents:

1.(a) \* Original/Certified copy of the instrument under which the trust/institution was created/established, together with a copy thereof.

(b) \* Original/Certified copy of document evidencing the creation of the trust or the establishment of the institution, together with a copy thereof. [The originals, if enclosed, will be returned.

2. Two copies of the accounts of the \* trust/institution for the latest \* one/two/three years.

I undertake to communicate forthwith any alteration in the terms of the trust, or in the rules governing the institution, made at any time hereafter.

*Date*

*Signature*

*Designation*

*Address*

\*Strike out whichever is not applicable.

### **Rule-17B**

#### **Audit report in the case of charitable or religious trusts, etc.**

17B. The report of audit of the accounts of a trust or institution which is required to be furnished under clause (b) of section 12A, shall be in Form No. 10B.

#### **FORM NO. 10B [See rule 17B]**

#### **Audit report under section 12A (b) of the Income-tax Act, 1961, in the case of charitable or religious trusts or institutions**

\* I/We have examined the balance sheet of [name of the trust or institution] as at and the Profit and Loss account for the year ended on that date which are in agreement with the books of account maintained by the said Trust or institution.

\* I/We have obtained all the information and explanations which to the best of \* my/our knowledge and belief were necessary for the purposes of the audit. In \* my/our opinion, proper books of account have been kept by the head office and the branches of the abovenamed \* trust/institution visited by \* me/us so far as appears from \* my/our examination of the books, and proper Returns adequate for the purposes of audit have been received from branches not visited by \* me/us, subject to the comments given below:

In \* my/our opinion and to the best of \* my/our information, and according to information given to \* me/us, the said accounts give a true and fair view-

- (i) in the case of the balance sheet, of the state of affairs of the abovenamed \* trust/institution as at .....and
- (ii) in the case of the profit and loss account, of the profit or loss of its accounting year ending on .....

The prescribed particulars are annexed hereto.

*Place:*

*Date"*

*Signed*

*Accountant †*

**Notes:**

- 1. \*Strike out whichever is not applicable.
- 2. †This report has to be given by -
  - (i) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 (38 of 1949); or
  - (ii) any person who, in relation to any State, is, by virtue of the provisions of sub-section (2) of section 226 of the Companies Act, 1956 (1 of 1956), entitled to be appointed to act as an auditor of the companies registered in that State.
- 3. Where any of the matters stated in this report is answered in the negative, or with a qualification, the report shall state the reasons for the same.

**STATEMENT OF PARTICULARS**

**I. APPLICATION OF INCOME FOR CHARITABLE OR RELIGIOUS PURPOSES**

1. Amount of income of the previous year applied to charitable or religious purposes in India during that year
2. Whether the trust/institution \* has exercised the option under clause (2) of the Explanation to section 11(1)? If so, the details of the amount of income deemed to have been applied to charitable or religious purposes in India during the previous year
3. Amount of income accumulated or set apart\* /finally set apart for application to charitable or religious purposes, to the extent it does not exceed 25 per cent of the income derived from property held under trust wholly \* /in part only for such purposes.
4. Amount of the income eligible for exemption under section 11(1)(c) (Give details)
5. Amount of the income, in addition to the amount referred to in item 3 above, accumulated or set apart for specified purposes under section 11(2)
6. Whether the amount of income mentioned in item 5 above has been invested or deposited in the manner laid down in section 11(2)(b) ? If so, the details thereof
7. Whether any part of the income in respect of which an option was exercised under clause (2) of the Explanation to section 11(1) in any earlier year is deemed to be the income of the previous year under section 11(1B) ? If so, the details thereof
8. Whether, during the previous year, any part of the income accumulated or set apart for specified purposes under section 11(2) in any earlier year-
  - (a) has been applied for purposes other than charitable or religious purposes or has ceased to be accumulated or set apart for application thereto, or
  - (b) has ceased to remain invested in any security referred to in section 11(2)(b)(i) or deposited in any account referred to in section 11(2)(b)(ii) or section 11(2)(b)(iii), or
  - (c) has not been utilised for purposes for which it was accumulated or set apart during the period for which it was to be accumulated or set

apart, or in the year immediately following the expiry thereof? If so, the details thereof

**II. APPLICATION OR USE OF INCOME OR PROPERTY FOR THE BENEFIT OF PERSONS REFERRED TO IN SECTION 13(3)**

1. Whether any part of the income or property of the \* trust/institution was lent, or continues to be lent, in the previous year to any person referred to in section 13(3) (hereinafter referred to in this Annexure as such person)? If so, give details of the amount, rate of interest charged and the nature of security, if any
2. Whether any land, building or other property of the \* trust/institution was made, or continued to be made, available for the use of any such person during the previous year? If so, give details of the property and the amount of rent or compensation charged, if any
3. Whether any payment was made to any such person during the previous year by way of salary, allowance or otherwise? If so, give details
4. Whether the services of the \* trust/institution were made available to any such person during the previous year? If so, give details thereof together with remuneration or compensation received, if any
5. Whether any share, security or other property was purchased by or on behalf of the \* trust/institution during the previous year from any such person? If so, give details thereof together with the consideration paid
6. Whether any share, security or other property was sold by or on behalf of the \* trust/institution during the previous year to any such person? If so, the \* trust/institution during the previous year to any such person? If so, give details thereof together with the consideration received
7. Whether any income or property of the \* trust/institution was diverted during the previous year in favour of any such person? If so, give details thereof together with the amount of income or value of property so diverted
8. Whether the income or property of the \* trust/institution was used or applied during the previous year for the benefit of any such person in any other manner? If so, give details

\*Strike out whichever is not applicable.

**III. INVESTMENTS HELD AT ANY TIME DURING THE PREVIOUS YEAR(S) IN CONCERNS IN WHICH PERSONS REFERRED TO IN SECTION 13(3) HAVE A SUBSTANTIAL INTEREST**

*Sl. No. Name and address of the concern*

*Where the concern is a company, number and class of shares held*

*Nominal value of the investment*

*Income from the investment*

*Whether the amount in col. 4 exceeded 5*

*Percent of the capital of the concern during the previous year-say, Yes/No*

Total

*Place:*

*Date:*

*Signed*

*Accountant*

**IMPORTANT FORMS FOR TRUSTS UNDER INCOME TAX ACT, 1961**

| SERIAL No. | FORM NO.        | PARTICULARS   |
|------------|-----------------|---|
| 1.         | FORM NO. 3CF-1. | Application Form for approval under clause (ii) of sub-section (1) of Section 35 of the Income Tax Act, 1961 in case of a Scientific Research Association           |
| 2.         | FORM No. 10     | Notice to the Assessing Officer/Prescribed Authority under Section 11(2) of the Income Tax Act, 1961  |
| 3.         | FORM No. 10A    | Application Form for registration of charitable or religious trust or institution under {clause (aa) of sub-section (1) of Section 12A} of the Income Tax Act, 1961 |
| 4.         | FORM No. 10B    | Audit Report under Section 12A(b) of the Income Tax Act, 1961, in the case of charitable or religious trusts or institutions  |
| 5.         | FORM            | Audit Report under section 10(23C) of the Income  |

|    |              |   |
|----|--------------|---|
|    | No. 10BB     | Tax Act, 1961, in the case of any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of Section 10(23C) |
| 6. | FORM No. 10G | Application for grant of approval or continuance thereof to institution or fund under section 80G(5)(vi) of the Income Tax Act, 1961  |
| 7. | FORM No. 56  | Application for grant of exemption or continuance thereof under Section 10(23C) (iv) and (v) for the year.....  |
| 8. | FORM No. 56D | Application for grant of exemption or continuance thereof under Section 10(23C) (vi) and (via) for the year.....  |

**IMPORTANT FORMS FOR SECTION 25 COMPANIES**

|    |              |  |
|----|--------------|--|
| 1. | FORM No. 24A | Application Form for filing application to Central Government ( Pursuant to sections 22, 25, 224(3), 224(7) and 297 of the Companies Act, 1956 |
|----|--------------|--|

## Appendix 3

# Some Select Judicial Decisions, Q&A and Tax Rates

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*DIT v. Meenakshi Amma Endowment Trust (2011) 50 DTR 243 (Karnataka High Court)*

Registration under section 12A of the Act cannot be denied to a trust which is newly formed on the ground that it had not commenced any activity. While granting registration under section 12A of the Act only the objects of the trust is to be examined to ascertain the genuineness of the trust.

Agriculture Produce and Market Committee (2007) 291 ITR 419 (Bom) & Disha India Micro Credit (Delhi)

Registration as a Public Trust is not a condition precedent for grant of registration under section 12A. There is no requirement in the Income-tax Act, 1961 that the institution constituted for advancement of charity, must be registered as a trust under the Public Trusts Act.

*Mehata Jivraj Makandas & Parekh Govindji Kalyani Modh Vanik Vidyarthi Public Trust v. Director of Income-tax (2011) 131 ITD 462 (Mum.)(Trib.)*

In instant case trust had been registered as a charitable institution under section 12A vide order dated 27-11- 1975. Subsequently, in view of the order dated 17-3-1994 of the Charity Officer under section 50A(1) of the BPT Act, objects of the Trust were amended. The Case of the revenue was that objects of trust could not be amended without the approval of the High Court. It was also argued that the changes in the objects of trust were not intimated to the department as provided in the Form No. 10A. The assessee contended that the when the change in the object clause approved by the Charity Commissioner under section 50A (1) approval of High Court is not required. Requirement of intimation of changes to department was provided only in Form no 10A, which was not a statutory requirement and in case the assessee had intimated the said change to department later on. Even the amended objects remained charitable and had not caused any detriment to original objects. The Tribunal held that the assessee trust continued to be eligible for registration under section 12A and thus, impugned order of DIT(E) rejecting for renewal of approval under section 80G could not be sustained.

Rajah Sir Annamali Chettiar Foundation v. DIT (2011) 48 SOT 502 (Chennai)(Trib.)

Assessee trust was formed to run educational institutions. It applied for registration under section 12AA. DIT(E) rejected the application on ground that probable fees to be collected from students was having a component for future expansion of institution and same component was in nature of profit and thus ,objects of trust would also include profit motive. The Tribunal held that since the object of trust was to establish a number of educational institutions in a brand name and run those institutions on commercial line, it could not be regarded as charitable activity, therefore, DIT (Exemption) was justified in rejecting assessee's application seeking registration under section 12AA.

**Q&A**

**Question 1**

Whether corpus given by one trust to another can be treated as the application of the fund?

**Reply**

The term "Corpus Fund" has not been defined in the Income Tax Act, 1961.

Corpus fund donations have been exempted from the income-tax under Section 11(1)(d) of the Income Tax Act, 1961 (**the Act**) in the following words;

*"Income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution."*

It is the amount donated by a donor with a specific direction that it shall form part of the Corpus of the trust or institution. The corpus is considered to be the capital of the trust or institution which should be kept intact. It may be utilised for the purchase of assets such as land, buildings, furniture, equipments etc. or it may be invested or deposited as per Section 11(5) of the Act, and the income arising there from may be utilised for the objects specified by the donor to the Corpus Fund.

In CIT v. Sarladevi Sarabhai Trust No. 2 [1988] 172 ITR 698/40 Taxman 388 (Guj.), it was debated whether donation by one charitable trust to another such trust, towards its corpus can be treated as application for charitable purposes. It was held that corpus donations are also permissible as valid application. In other words, a charitable organisation can make inter-charity donation towards corpus and also claim exemption even if the donee organisation does not apply those funds for charitable or religious purposes.

High Courts in various cases, have also held that inter-charity donations towards corpus is a valid application.

**Question 2**

Can a trust contribute to the corpus from the accumulated fund i.e. Reserves & surplus?

**Reply**

The Finance Act, 2002 has inserted an Explanation to sub-section (2) of section 11 of the Act.

*“Any amount credited or paid, out of income referred to in clause (a) or clause (b) of sub-section (1), read with the Explanation to that sub-section, which is not applied, but is accumulated or set apart, to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.”*

This Explanation prohibits donations to other Charitable Organisations out of the accumulated funds. In other words, funds once accumulated under section 11(2) can only be applied for charitable purposes directly by the concerned organisation and any inter-organizational transfer would not be possible. However, there is no apparent bar on payment or credit to such other organisations out of previous year's income subject to the provisions of section 11(1).

In the light of the above, funds once accumulated are no longer available for credit or payment to any other Charitable Organisation, though such transfer may still be possible out of the current year's income under section 11. CBDT has also issued a clarificatory circular no. 8, dt. 27.08.2002.

However, donations to other Charitable Organisation are still possible but only out of the current year's income. Once the funds are accumulated then it will not be permissible to make inter-trust donation and treat them as application.

In this context it may be noted that the Explanation to sub-section (2) of section 11 applies only to the funds accumulated under section 11(2), it does not apply to other accumulated funds and reserves. In the case of Director of Income-tax (Exemption) v. Bagri Foundation [2010] 192 Taxman 309 (Delhi), it was held that inter-charity donation out of other accumulated funds was permissible.

The Finance Act, 2003 has inserted another proviso to sub-section (3A) of section 11 which provides that inter-charity donation out of accumulated funds will be permissible in case of dissolution of a Charitable Organisation.

*"Provided further that in case the trust or institution, which has invested or deposited its income in accordance with the provisions of clause (b) of sub-section (2), is dissolved, the Assessing Officer may allow application of such income for the purposes referred to in clause (d) of sub-section (3) in the year in which such trust or institution was dissolved."*

### **Question 3**

Can a trust contribute from the capital gains towards the corpus of the other trust?

### **Reply**

Income, as defined under section 2(24) of the Act, includes Capital Gains. Therefore, for the purposes of section 11(1)(a) of the Act, Capital Gains are also considered as a part of the income.

Since, Capital Gains are also considered as a part of the income, therefore, they can be applied for charitable or religious purposes.

But, if Capital gains are also applied for charitable and religious purposes, then it will amount to depletion of the Corpus of the organisation. In order to overcome this disadvantage, the Act has provided another option under section 11(1A), by virtue of which Capital Gains can be re-invested in another Capital Asset without losing exemptions.

As per section 11(1A) of the Act,

*"For the purposes of sub-section (1),—*

- (a) where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—*
  - (i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of such capital gain;*
  - (ii) where only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gain*

*as is equal to the amount, if any, by which the amount so utilised exceeds the cost of the transferred asset;*

- (b) *where a capital asset, being property held under trust in part only for such purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—*
- (i) *where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;*
- (ii) *in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset."*

Under section 11(1A), if the entire amount of net consideration is invested in another Capital Asset then, the entire Capital Gain will be deemed to have been applied for Charitable or Religious purposes and if a part of the entire amount of net consideration is invested in another Capital Asset, then, the appropriate fraction of the Capital Gain will be deemed to have been applied for charitable or religious purposes.

#### **Question 4**

Does basic exemption limit i.e. ₹ 2,00,000/ available to the trust for computation of income?

#### **Reply**

A charitable trust etc. is required to file suo-moto returns under section 139(4A) provided its income, representing aggregate of voluntary contributions, defined u/s 2(24)(iia), exceeds the maximum amount not chargeable to income-tax. Form No. 3A has been prescribed as the return of income. The trust etc. has to get its accounts audited and a report of the auditor in Form 10B has to be filed alongwith the return.

As per Section 139(4A) of the Act,

*"Every person in receipt of income derived from property held under trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes, or of income being voluntary contributions referred to in sub-clause (iia) of clause (24) of section 2, shall, if the total income in*

*respect of which he is assessable as a representative assessee (the total income for this purpose being computed under this Act without giving effect to the provisions of sections 11 and 12) exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under sub-section (1)."*

Thus, A Trust which is registered with the Income Tax Department under Section 12A of the Act is required to file a return of Income, if its total income, without claiming any deductions there from exceeds the maximum amount which is not chargeable to income tax (for assessment year 2012-13 the said amount is ₹ 1,80,000 and for the assessment year 2013-14 the said amount is ₹ 2,00,000).

#### TAX RATES

| Slab rates for Trust, Society, Sec 25 companies, cooperatives under Income Tax Act                         |  |  |
|--|--|--|
|  | Assessment Year 2012-13  | Assessment Year 2013-14  |
| Trust/<br>Society  | Upto ₹ 1,80,000 NIL<br>Rs.1,80,000 to ₹ 5,00,000<br>10%<br>₹ 5,00,000 to ₹ 8,00,000<br>20%<br>Above ₹ 8,00,000 30% | Upto ₹ 2,00,000 NIL<br>Rs.1,80,000 to ₹ 5,00,000<br>10%<br>₹ 5,00,000 to ₹ 10,00,000<br>20%<br>Above ₹ 10,00,000 30% |
| Section 25<br>Company  | 30% along with 5% surcharge if income exceeds 1 crore.   | 30% along with 5% surcharge if income exceeds 1 crore.   |
| Cooperative<br>Society   | Upto ₹ 10,000 10%<br>Rs.10,000 to ₹ 20,000 20%<br>₹ 20,000 and above 30%   | Upto ₹ 10,000 10%<br>₹ 10,000 to ₹ 20,000 20%<br>₹ 20,000 and above 30%  |
| Education cess @ 2% of income tax and Secondary and higher education cess @ 1% of income tax in all cases. |  |  |

## Appendix 4

# Research Questions Posed to A Select Group of Respondents

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| Serial No. | Research questions  |
|------------|---|
| 1.         | Whether taxation laws, regulation and policies are in harmony with the needs of the Cooperatives and NPO Sectors?   |
| 2.         | Whether taxation laws, regulations and policies imposes restrictions and hardships on enjoyment of tax exemptions by the Cooperatives and NPO Sectors?  |
| 3.         | What is the global experience in providing tax exemptions to the Cooperatives and NPO Sectors?  |
| 4.         | What are the new challenges for the regulatory bodies (dealing with Taxation, regulation etc. for Cooperatives and NPO Sectors) in changing social, economic and political scenario in respect of taxation matters? |
| 5.         | What are the reforms, improvements and amendments required in the taxation laws, regulations and policies which are currently applicable to the Cooperatives and NPO Sectors?                                       |
| 6.         | Whether taxation laws and regulations may play a positive role in increase in the overall well being and happiness of the people of India?  |
| 7.         | Whether restrictions on tax exemptions are required to minimize misuse by the persons and organizations for their personal benefits?  |
| 8.         | Any other comment/suggestion.   |