



Resource support on NGO Governance, Accounting and Regulations



# Standards & NORMS

An initiative of FMSF & VANI

Legal Series Vol. V, Issue 4, July 2012

*For private circulation only*

## BUSINESS ACTIVITY CANNOT AFFECT CHARITABLE STATUS

*(Analysis of Tax Provisions for NPOs after Finance Act, 2012)*



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### INTRODUCTION

**1.01** The Finance Act, 2012 has not made any substantial amendment to the provisions related with the taxation of charitable organisations. However, there are few very crucial changes which are as under :

- ◆ Under the existing provisions, an NPO cannot have business activity in excess of ₹ 25 lakh during the year. This provision created a lot of hardship to NPOs because the Assessing Officer (AO) started treating NPOs as commercial organisations, the moment the commercial activities exceeded the permissible limit. The Finance Act, 2012 has made a very important change by clarifying that NPOs will continue to remain charitable

organisations even if the business activity exceed ₹ 25 lakhs. The AO can deny the Income Tax exemptions only for that particular year.

- ♦ The other important change made by the Finance Act, 2012 is that any donation under section 80G has to be made otherwise than in cash, if the amount exceeds ₹ 10,000/-. In other words, donation in excess of ₹ 10,000/- under section 80G should be made through account payee bank transfers.

## RECOLLECTING THE LAW RELATING TO BUSINESS ACTIVITIES OF NPOs

**2.01** It is worthwhile to recall that the amendments in the definition of 'charitable purpose' under section 2(15) in the year 2008 had far reaching implications on the business income of charitable organisations. It may be noted that the NGOs engaged in advancement of any other object of general public utility, **were not allowed to have any incidental business activity**. The Finance Act, 2010 retrospectively provided relief to small NGOs by providing a limit of ₹ 10 lakh. And Finance Bill 2011 had further increased this limit to ₹ 25 lakh. However, this enhancement was prospective in nature and will be applicable from the assessment year 2012-13.

**2.02** The definition of 'charitable purpose' can be divided into 6 parts, viz. (i) relief of poor, (ii) education, (iii) medical relief, (iv) preservation of environment, (v) preservation of monuments or places or objects of artistic or historic interest, (vi) advancement of any other object of general public utility. However, the Finance Act, 2008 w.e.f. 1-4-2009 had excluded any trade, commerce or business related activity by any trust or NGO engaged in the sixth category i.e. advancement of any other object of general public utility, from the purview of 'charitable purpose'. In other words an NGO exclusively engaged in the field of education, medical relief, relief of poor, preservation of environment & preservation of monuments can have incidental business activity without any monetary ceiling.

**2.03** Therefore, w.e.f. 01.04.2009 the income from trade, commerce or business pertaining to those NGOs which come under the sixth category of 'charitable purpose' were not be treated as charitable activity and the entire exemption of such NGOs was at stake. Consequently, such organisations were not eligible for any exemption under section 11 or other provisions which provide exemptions towards charitable purpose. It may be noted that the issue of incidentality of business will not be relevant to such group of NGOs. Whether the business activity is incidental or not, is of no consequence, as this sixth category of NGOs would lose the charitable status. However, the Finance Bill, 2011 had provided a great relief to the sixth category NGOs as NGOs having business activities to the extent of rupees 25 lakh (receipt) will not be affected.

**2.04** It is pertinent to note that all other NGOs (other than the NGO coming under the sixth category) can have business related activity beyond ₹ 25 lakh, as permitted under section 11(4A), and other provisions pertaining to business activities shall be applied without any changes.

**2.05** Hitherto the law was very liberal with regard to the business activities of NGOs

and even income from unrelated businesses (for example, publishing newspapers) held by them was eligible for exemption if the entire income was used for charitable purposes. The law would continue to remain liberal for the first five categories of NGOs. The NGOs were facing problem during the assessment stages where in many cases the AO was withdrawing the charitable status of the NGOs, if violation of the aforesaid provisions regarding business activities was noticed. Now the Finance Bill 2012 has provided great relief by making appropriate amendments which provide that the AO has no power to ignore charitable status of an NGO unless the registration is cancelled by the Commissioner of Income Tax under section 12AA(3). The AO can only withdraw the exemption for that particular year.

## AMENDMENTS BY FINANCE ACT 2012

**3.01** The Finance Act, 2012 has made the following changes to the Act with retrospective effect from the 1st day of April, 2009:

1. In clause (23C) of section 10, the following proviso has been inserted:—  
*“Provided also that the income of a trust or institution referred to in sub-clause (iv) or sub-clause (v) shall be included in its total income of the previous year if the provisions of the first proviso to clause (15) of section 2 become applicable to such trust or institution in the said previous year whether or not any approval granted or notification issued in respect of such trust or institution has been withdrawn or rescinded;”*
2. In section 13, the following sub-section has been inserted:—  
*“(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.”*
3. The following sub-section (5D) has been inserted after sub-section (5C) of section 80G by the Finance Act, 2012, w.e.f. 1-4-2013 :  
*“(5D) No deduction shall be allowed under this section in respect of donation of any sum exceeding ten thousand rupees unless such sum is paid by any mode other than cash.”*
4. The following sub-section (2A) has been inserted after sub-section (2) of section 80GGA by the Finance Act, 2012, w.e.f. 1-4-2013 :  
*“(2A) No deduction shall be allowed under this section in respect of any sum exceeding ten thousand rupees unless such sum is paid by any mode other than cash.”*
5. In section 143(3), following proviso has been inserted:—  
*“Provided also that notwithstanding anything contained in the first and the second proviso, no effect shall be given by the Assessing Officer to the provision of clause (23C) of section 10 in the case of a trust or institution for a previous year, if the provisions of the first proviso to clause (15) of section 2 become applicable in the case of such person in*

*such previous year, whether or not approval granted to such trust or institution or notification issued in respect of such trust or institution has been withdrawn or rescinded."*

**3.02** The explanatory notes and memorandum to the Finance Bill, 2012 are provided in **Annexure 1**.

## **IMPACT OF RECENT CHANGES INCLUDING FINANCE ACT, 2012**

**4.01** The summary of the impact of the recent changes including Finance Act, 2012 is as under :

- The organisation falling in the sixth limb shall lose its exemption, for that particular year, if the gross receipts from trade, commerce or business exceeds rupees 25 lakh.
- The Finance Act 2012 has clarified that the AO does not have any power to question the charitable status of an organisation. He can only deny the exemption for that particular year.
- The exemption shall be lost only if commercial or business activities are found in excess of rupees 25 lakhs. There may be various business or profit oriented activities which may not be treated as commercial or business activity. For the purposes of computing ₹ 25 lakh, the gross receipt shall be considered and not the net income.
- Even if an organisation is found to be doing commercial or business activity in excess of rupees 25 lakhs, it will not effect its charitable status. It will continue to remain a charitable organisation, unless such status is withdrawn by the CIT under Section 12AA(3).
- The organisations falling in the first 5 limbs can continue to have incidental business activity even beyond rupees 25 lakhs. The first 5 limbs are (i) relief of the poor, (ii) education, (iii) medical relief, (iv) preservation of environment (including watersheds, forests and wildlife) (v) preservation of monuments or places or objects of artistic or historic interest.
- The other important change made by the Finance Act, 2012 is that any donation under the 80G or 80GGA has to be made otherwise than in cash, if the amount exceeds ₹ 10,000/-. In other words, the donor will not get tax benefits if he/she makes more that ₹ 10,000/- in cash. We understand the cash limit of ₹ 10,000/- shall be for the total donation made by a donor during the year.

## **CASES WHICH HELD THAT THE AO DOES NOT HAVE POWER TO QUESTION CHARITABLE NATURE**

**5.01** Even prior to the changes made in the Finance Act 2012, it had been held that the AO does not have the power to withdraw the charitable status. He can only examine the allowability of exemption u/s 11. In the case *Rajasthan Housing*

*Board v. Commissioner of Income-tax, Jaipur-II* [2012] 21 taxmann.com 77, (2012) 51 SOT 383 (Jaipur-Trib.) it was held that registration of institution u/s 12AA cannot be cancelled if its receipts from trade, commerce, etc., exceeds ₹ 10Lakhs or ₹ 25 Lakhs limit u/s 2(15). If in any year, the gross receipts from the trade or commerce of the Institution exceeds the limit stipulated in the second proviso to section 2(15) of ₹ 10 lakhs or ₹ 25 lakhs, as the case may be, then in that year, the Assessing Officer is empowered to examine the allowability of exemption u/s 11 but the same has no effect on granting the registration u/s 12AA of the Act. Section 12AA(3) provides for cancellation of registration of a trust or institution only on the grounds 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'. Section 12AA(3) does not envisage examination of activities of trust in the light of section 2(15) and does not provide for cancellation on the grounds of violation of the two provisos of section 2(15).

**5.02** Similarly in the case of *Cane Development Council v. CIT* [2010] 35 SOT 308 (DELHI), [2010] 033 DTR 0170, [2010] 128 TTJ 0316, the Assessee was a sugarcane development council. It was constituted to consider and approve programme of development for zone; and to devise ways and means for execution of development plan in all its essentials such as cane varieties, cane seeds, sowing programme, fertilizers and manures, etc. The assessee was originally granted registration under section 12AA by Commissioner on 15-11-2007. However, subsequently, Commissioner on noticing proviso to section 2(15) defining phrase 'Charitable purposes' which came into effect from 1-4-2009 held that assessee's activities would ordinarily be not regarded as 'charitable' because for each and every development activity, it charged fees in shape of contribution. He, therefore, withdrew registration granted to assessee. It was held that the assessee was charitable in nature and, therefore, registration granted to it could not have been withdrawn. The changes in the proviso to section 2(15) defining phrase 'Charitable purposes' which came into effect from 1-4-2009 shall not have any impact on the assessee, and the CBDT Circular No. 11, dated 19-12-2008 was not applicable.

## **25 LAKHS LIMIT SHALL BE AVAILABLE FROM ASSESSMENT YEAR 2012-13**

**6.01** It may be noted that the aforesaid amendments have become retrospectively effective from 01.04.2009. It implies that the provision of section 2(15) as it stood in the respective assessment year shall be applicable from 01.04.2009. It may be noted that the limit of gross business or commercial activities was ₹10 Lakhs upto the assessment year 2011-12 and ₹25 Lakhs the assessment year 2012-13 onwards. In the case of *Rajasthan Housing Board v. Commissioner of Income-tax, Jaipur-II* [2012] 21 taxmann.com 77, (2012) 51 SOT 383 (Jaipur-Trib.) it was observed that the AO cannot withdraw the charitable status or disallow the exemption if the limit of gross business or commercial activities exceeds ₹10 Lakhs or ₹ 25 lakhs as the case may be depending on the assessment year. The relevant extract is as under :

"By the amended provisions of section 2(15) it has been provided that if in any year the gross receipts of an institution exceeds ₹ 10 lakhs, (now ₹ 25 lakhs with effect from 1-4-2012), then in that case, exemption under section 11 may not be allowed to the Institution as the activities of the institution will be treated as

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not charitable if the receipts exceed said limit. The exemption under section 11 is to be examined on yearly basis, therefore, the exemption under section 11 has no effect for granting registration under section 12AA. [Para 8]

The objectives of the assessee institution have already been examined by the Tribunal who directed to grant registration to the institution. There is no doubt in this regard. Therefore, the Commissioner was not justified in holding that in view of amended provisions of section 2(15), the Institution does not remain a charitable institution and, therefore, the objectives of the institution also do not remain as charitable and, accordingly, withdrawal of registration, was not justified. [Para 9].

**EXPLANATORY NOTES AND MEMORANDUM OF FINANCE BILL 2012****Notes on Clauses to the Finance Bill 2012**

Clause 5 of the Bill seeks to amend section 10 of the Income-tax Act relating to income not included in total income. It is proposed to insert a new proviso after the sixteenth proviso to clause (23C) of the aforesaid section so as to provide that the income of a trust or institution referred to in sub-clause (iv) or subclause (v) shall be included in its total income of the previous year if the provisions of the first proviso to clause (15) of section 2 becomes applicable to such trust or institution in the said previous year, whether or not any approval granted or notification issued in respect of such trust or institution has been withdrawn or rescinded. This amendment will take effect retrospectively from 1st April, 2009 and will, accordingly, apply in relation to the assessment year 2009-2010 and subsequent assessment years.

Clause 6 of the Bill seeks to amend section 13 of the Income-tax Act relating to section 11 not to apply in certain cases. It is proposed to insert a new sub-section (8) in the aforesaid section 13 so as to provide that 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. This amendment will take effect retrospectively from 1st April, 2009 and will, accordingly, apply in relation to the assessment year 2009-2010 and subsequent assessment years.

**Memorandum to Finance Bill, 2012**

It is further proposed to insert a new proviso to sub-section (3) of the aforesaid section so as to provide that notwithstanding anything contained in the first and the second proviso, no effect shall be given by the Assessing Officer to the provisions of clause (23C) of section 10 in case of a trust or institution for a previous year, if the provisions of first proviso to clause (15) of section 2 become applicable in the case of such person in such previous year whether or not the approval granted to such trust or institution or notification issued in respect of such trust or institution has been withdrawn or rescinded. This amendment will take effect retrospectively from 1st April, 2009 and will, accordingly, apply in relation to the assessment year 2009-2010 and subsequent assessment years.

Assessment of charitable organization in case commercial receipts exceed the specified threshold Sections 11 and 12 of the Act exempt income of any charitable trust or institution, if such income is applied for charitable purposes in India and such institution is registered under section 12AA of the Act. Section 10(23C) of Income Tax Act also provides exemption in respect of approved charitable funds or institutions. Section 2(15) of the Act provides definition of charitable purpose. It includes "advancement of any other object of general public utility" as charitable purpose provided that it does not involve carrying on of any activity in the nature of trade, commerce or business. The 2nd proviso



to said section provides that in case where the activity of any trust or institution is of the nature of advancement of any other object of general public utility, and it involves carrying on of any activity in the nature of trade, commerce or business; but the aggregate value of receipts from the commercial activities does not exceed ₹ 25,00,000/- in the previous year, then the purpose of such institution shall be considered as charitable, and accordingly, the benefits of exemption shall be available to it. Thus, a charitable trust or institution pursuing advancement of object of general public utility may be a charitable trust in one year and not a charitable trust in another year depending on the aggregate value of receipts from commercial activities.

There is, therefore, need to expressly provide in law that no exemption would be available for a previous year, to a trust or institution to which first proviso of sub-section 2(15) become applicable for that particular previous year. However, this temporary excess in one year may not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval or rescinding of notification issued in respect of trust or institution. Therefore, there is need to ensure that if the purpose of a trust or institution does not remain charitable due to application of first proviso on account of commercial receipt threshold provided in second proviso in a previous year. Then, such trust or institution would not be entitled to get benefit of exemption in respect of its income for that previous year for which such proviso is applicable. Such denial of exemption shall be mandatory by operation of law and would not be dependent on any withdrawal of approval or cancellation of registration or a notification being rescinded. It is, therefore, proposed to amend section 10(23C), section 13 and section 143 of the Act to ensure that such organization does not get benefit of tax exemption in the year in which it's receipts from commercial activities exceed the threshold whether or not the registration or approval granted or notification issued is cancelled, withdrawn or rescinded. This amendment will take effect retrospectively from 1st April, 2009 and will, accordingly, apply in relation to the assessment year 2009-10 and subsequent assessment years.

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Published by **Mr. Sanjay Patra** on behalf of  
**FINANCIAL MANAGEMENT SERVICE FOUNDATION**  
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