

INTER *face*

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NPO Taxation - Registration of Oral Trust Formed Without Deed

FCRA - Confusions in Computation of Administrative Expenditure

Tax Audit of NPOs - Audit Report Under Form 10B and Form 10BB

Allocation of Common Costs

The opinions and analysis expressed by the authors are their independent opinions and not necessarily that of FMSF. The quality and accuracy are of the utmost importance to us so if you spot an error in any article, kindly send at fmsf@fmsfindia.org with full details. Our team will work to verify the error and take necessary actions to avoid any such mistakes in future editions.

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"The pessimist complains about the wind. The optimist expects it to change. The leader adjusts the sails"-John C. Maxwell

Friends, we have three choices to make: complain, wait and remain hopeful, or take action. Innumerable times, we come across such situations in life, and the choices we make determine their eventual fate. I believe anyone can be a leader, and it does not fall on the designated leaders to take action. Leadership is about decision-making, and the ability to take decisions stems from the ability of an individual to take on responsibilities.

As we are going through pervasive changes, the onus also lies on us to 'adjust the sails'. Complaining and hoping are the two sides of the coin of inaction. No matter how many times you flip it, you are still stuck with those two choices, and in the meantime, nothing gets done. Be a leader; otherwise, nothing will get done, and that is rarely going to be the best option.

With these words, let me take the opportunity to welcome you to the latest edition of our newsletter **"Interface"**. I believe that in the realm of non-profits, strong financial management is the cornerstone of sustainable impact. As we traverse the ever-evolving landscape, "Interface" serves as a beacon of knowledge and expertise and a medium to stay informed about the latest developments and regulations.

In this issue, we have curated insightful content that reflects the dynamic world of financial management, governance, and compliance. From navigating the intricacies of NPO taxation, budget planning, and FCRA-related matters to the critical aspects of financial management, such as common cost allocation and vital legal compliance matters, we invite you to explore the essence of effective financial stewardship.

Our aim with this newsletter is simple yet profound: to empower you, our partners, and our community with the tools and insights needed to make a difference. At the heart of our mission lies a dedication to capacitating the development sector and "Interface" is our avenue to share, engage, and catalyse change.

Sandeep Sharma

We are grateful to the authors who have contributed for the articles in this edition.

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Want to join our group of eminent authors? Write an article on Governance, Financial Management or Compliance and send it to us. We will review and get back to you.

- Editorial Team

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NPO Taxation - Registration of Oral Trust Formed Without Deed

Introduction

There are many old religious and charitable trust which do not have a formally registered trust deed. Such institutions find it difficult to get registration under section 12AB of the Income Tax Act, 1961 for availing tax exemptions. In this issue, the procedure for obtaining registration under section 12AB for such trust has been discussed.

Article 19 of the Constitution of India guarantees the right to form associations, including establishing trusts for charitable and religious purposes. As a result, even an oral trust is eligible for registration under Section 12AB. However, the trust must provide supporting evidence and documents to demonstrate its authenticity.

Documents to be Submitted

Pursuant to Rule 17A of the Income-tax Rules, 1962, in cases where the applicant is created or established in a manner other than through an instrument, a self-certified copy of the document evidencing the creation or establishment of the applicant must be submitted along with the application in Form 10A or 10AB.

In cases, where a trust has not been formally registered under any Act, the following documents may be submitted at the time of registration under section 12AB:

- (i) An affidavit executed before a magistrate declaring the facts and history of the trust;
- (ii) Revenue records relating to lands held by the trust;
- (iii) Orders relating to the assessment of property tax;
- (iv) Affidavits and declarations of citizens in support of the existence of the trust;
- (v) An activity report; and
- (vi) Financial statements, among other relevant documents.

Registration Under Section 12AB

A charitable trust created without any instrument can be registered under Section 12AB of the Income-tax Act. However, in order to apply for registration, a document that verifies the creation of the trust must be submitted alongside the application form.

On March 26th, 2021, the Central Board of Direct Taxes (CBDT) announced the Income-tax (6th Amendment) Rules, 2021. These rules are effective from April 1st, 2021. The revised Rule 17A (Application for registration of charitable or religious trusts etc.) is that specific documents must accompany an application in Form No. 10A or 10AB.

where the applicant is created, or established, otherwise than under an instrument, self-certified copy of the document evidencing the creation or establishment of the applicant;

To summarise, although a trust formed without a formal instrument can be registered under the Income-tax Act. Still, certain documents must be submitted alongside the application form to verify the organisation's existence and purpose.

Meaning of Document Evidencing Creation of Trust

The matter concerning the document that provides evidence of the establishment of the trust was raised in the case of *Laxminarayan Maharaj v. CIT* [1984] 17 Taxman 80/150 ITR 465 (MP).

Facts: The petitioner, a public religious trust, which was created more than a hundred years back but not under any instrument or document, made an application under section 12A for registration of the trust and along with the application filed:

- (i) revenue records relating to lands held by the trust;
- (ii) orders relating to the assessment of property tax; and
- (iii) affidavits and declaration of citizens in support of the existence of the trust.

The Commissioner rejected the petitioner's application on the ground that all these

documents, though evidencing the existence of the trust, were not documents evidencing the creation of the trust so that the requirement of rule 17A was not satisfied.

Held: An analysis of section 12A(a) and rule 17A(a) shows that the fact to be established is the creation of trust and this fact is required to be established by producing constitutive and evidential documents. When the trust is created under an instrument, the rule requires the production of the constitutive document itself. When the trust is not created under an instrument, it is impossible to produce any constitutive document and, hence, the rule requires production of evidential documents. The evidential documents cannot be limited to documents which directly prove the creation of the trust; they will embrace all documents which afford a logical basis of inferring creation of the trust and all such documents can be described to be 'documents evidencing the creation of the trust' within the meaning of rule 17A(a).

In the instant case, it was apparent that the documents produced by the petitioner, though not directly evidencing the creation of the trust, afforded a logical basis for inferring the creation of the trust and could be described as documents evidencing the creation of the trust for the purposes of rule 17A.

The order of the Commissioner was, accordingly, quashed and he was directed to reconsider the petitioner's application in the light of the observations made above.

Therefore, in the aforementioned case, the Court opined that producing constitutive documents would be impossible if a trust was

not established through an instrument. Therefore, Rule 17A required the production of evidential documents to establish the fact of the trust's creation. The Court held that the scope of evidential documents should not be limited to those that directly prove the creation of the trust but should include all documents that provide a logical basis for inferring the creation of the trust. Narrowly interpreting the phrase "documents evidencing the creation of the trust" would make it exceedingly challenging to register a trust that was not created under an instrument, which could not have been the intention of the rule.

Oral Trust Without Evidence of Creation

The ITAT Delhi in the case of *Tsurphu Labrang v. DIT (Exemptions)* ITA Nos. 4941 of 2011 and 3061 of 2013, judgment dated 08-09-2015 held that Rule 17A itself provides that the Institution/Trust doesn't need to be established under an instrument. Rule 17A does not prescribe that in case the Institution/Trust is established otherwise than under an instrument, what type of document evidencing the creation of the Trust or the establishment of the Institution, has to be filed, meaning thereby that the document evidencing the creation of Trust or the establishment of Institution could be of any type. As per the provisions of the Indian Trust Act, the Trust can be created even orally and if the assessee is able to give some evidence of the creation of such Trust by a word of mouth, the same shall be eligible for registration u/s 12AA/12A, provided such evidence is filed and the other conditions under the statute are satisfied.

The ITAT relied on the case *Laxminarayan Maharaj v. CIT* [1984] 17 Taxman 80/ 150 ITR 465 (MP), where the trust was created 100 years ago without any instrument of document. However, the revenue records relating to land held by the trust, orders relating to property tax and affidavits and declaration of citizens were in support of the existence of trust and were filed along with application for registration u/s 12A of the Act. The Commissioner of Income Tax rejected the application on the ground that though documents evidenced existence of trust but did not evidence the creation of the trust. Hon'ble Madhya Pradesh High Court held that the document accorded a logical basis for inferring the creation of the trust and the matter was remanded back to the Commissioner to reconsider the application of the trust in the light of the observations made by the Hon'ble High Court. The SLP against this decision of Hon'ble Madhya Pradesh High Court in *CIT v. Laxminarayan Maharaj* was dismissed by the Hon'ble Apex Court in 186 ITR 32 (St.) (SC).

The High Court of Gujarat in the case of *Principal CIT (Exemptions) v. Dawoodi Bohra Masjid* [2018] 90 taxmann.com 312 held that where assessee religious trust did not provide registered trust deed but proved factum of the existence of trust through all evidential documents, registration under section 12AA was to be granted. The Court relied on the precedent set by *Laxminarayan Maharaj v. CIT* [1984] 150 ITR 465/17 Taxman 80 (MP). The relevant extracts of the case are as under:

"From the materials on record, it can be seen that the Tribunal had gone through the registration details of the assessee-trust contained in the order of Waqf Board and was satisfied that full details of the functions of the trust were available which would establish the existence of the trust, its registration by the Gujarat State Waqf Board which also contained details of the objects of the trust, manner of appointment of Mutawalli etc. [Para 6]

Clause (a) of rule 17A requires that the application of registration under section 12A of a charitable or religious trust or institution would be accompanied by the following documents namely, where the trust is created or the institution is established, under an instrument, the instrument in original 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. Rule 17A nowhere envisages the existence of a trust deed or its registration. The factum of existence of trust could also be established by producing documents evidencing the creation of the trust. This is precisely what has been done in the present case. The order passed by

Waqf Board recognises various Daudi Vora trust and in case of present assessee also enlisted the objects of the trust, who would be the managers of the trust and how such managers would be appointed or removed. [Para 7]

If the trust is created under an instrument, rules require production of documents. However, when the trust is not created, it is impossible to produce any such documents. Hence, the rule requires production of evidential documents. [Para 8]"

The ITAT Chandigarh Bench 'B' in the case of Temple Trust vs. Commissioner of Income-tax (Exemptions) [2022] 142 taxmann.com 12 (Chandigarh - Trib.)/[2022] 196 IT... held that where assessee, an ancient temple, was acquired by State Government under Himachal Pradesh Hindu Public Religious Institution and Charitable Endowment Act, 1984 and objects of assessee-temple and bye-laws were directly addressed in terms of provisions of Endowment Act, 1984, Commissioner (Exemption) could not deny registration under section 12AA merely on ground that there was no original trust deed available, as assessee was taken over to fulfil charitable activities in terms of preamble of Endowment Act, 1984.

NPO Taxation - Contribution in Kind

Overview

Certain charitable/ religious institutions like hospitals, crèches, orphanage, schools, etc., often receive donations in kind from various sources for application towards their charitable purposes. These contributions are in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipment, etc.

Section 12(1) provides any voluntary contribution, received by a trust wholly for charitable or religious purposes, will be deemed to be its income derived from property held under trust. By virtue of Section 2(24)(iia) and 12, donations will be income for the purpose of Section 11. Section 12(1) does not specifically exclude contribution in kind.

However, in the light of the fact that contribution in kind is, generally, not available for application in cash and in many occasion such contribution may not have a realisable value in cash. CBDT has also issued a Circular No. 580, dated 14-9-1990 in which it has clarified that such contribution in kind, which are useable for charitable purpose in the same form in which these are received, shall be deemed to have been utilised based on evidence of such use.

The above circular was issued with reference to section 10(23C) but the same ratio should hold good even for 12AB registered organisation as

long as the donation received in kind are directly usable for charitable purposes in the form it is received and such use is established.

Donation-in-kind of assets in the form of impermissible mode of investment as per Section 11(5) may include shares, debenture of a company or jewellery to a charitable institution. Such donations are subject to Section 13(1)(d) which requires the funds are to be invested or held or deposited after 28-2-1983 in any mode as specified under section 11(5) of the Act and any violation thereof shall result into taxation of the amount of income equivalent to the amount of investment @ 30% u/s 115BBI.

Donation-in-kind is not subject to benefit of Sec. 80G and therefore, the donor is not eligible to claim any deduction u/s 80G if the donations are made in kind.

Concept of Donation-in-Kind

Certain charitable/ religious institutions like hospitals, crèches, orphanage, schools, etc., often receive donations-in-kind from various sources for application towards their charitable purposes. These contributions are in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipment, etc.

The donations received in-kind normally comprises the following:

- (a) consumable items such as clothes, grains and drugs;
- (b) books and hospital equipment, building for the use of school etc. which are capital assets to be used for charitable purpose;
- (c) shares, units in mutual fund, debentures and other items, which are income yielding assets; and
- (d) other capital assets like land, jewellery, etc.

As a matter of fact, there is no specific provision in the Income Tax Act, either dealing with contribution-in-kind or segregating it from cash donations, except clause (b)(iv) of third proviso to section 10(23C). However, there are CBDT Circulars and court rulings based on which the legal treatment of various contribution in kind has been analysed.

Whether Donation-in-Kind is treated as Income Under Section 11

Section 12(1) provides any voluntary contribution, received by a trust wholly for charitable or religious purposes, will be deemed to be its income derived from property held under trust. By virtue of Section 2(24)(ia) and 12, donations will be income for the purpose of Section 11.

As the section refers to "voluntary contributions", and not only contributions in cash, therefore even donations in-kind should constitute part of the total income of a trust for the purpose of Section 11. However, in the light of the fact that contribution-in-kind are, generally, not available for application in cash and in many occasion such contribution may

not have a realisable value in cash. CBDT has also issued a Circular No. 580, dated 14-9-1990 in which it has clarified that such contribution-in-kind, which are useable for charitable purpose in the same form in which these are received, shall be deemed to have been utilised on the basis of evidence of such use.

Further, if the contribution is in the nature of asset or investment which may or may not have come with a direction to be a part of corpus fund, then if it is a donation in the shape of capital asset, there is no need to treat it as income, however, over such investment shall still be subject to conversion to section 11(5) compliant investment under section 13(1)(d) as discussed below. In other words, any capital asset received as donation shall not be required to be applied for charitable purposes, only income from such asset shall be subject to application. It would not matter whether a specific direction for corpus donation is received or not.

It may be noted that the term income under section 2(24)(ia) excludes legal obligation and if any responsibility of any asset is handed over to a trust by the donor, it should be treated as a legal obligation unless it comes in the form of an investment which could be easily liquidated.

CBDT vide Instruction No. 883, dated 24-9-1975, has clarified that investments in fixed deposits with a tenure of more than 6 months are considered as capital assets for the purposes of section 11(1A). In the case of DIT (Exemption) v. DLF Qutab Enclave Complex Medical Charitable Trust [2001] 115 Taxman 520 (Delhi), it was held that investment for a fixed term in scheduled bank fulfils conditions provided in section 11(1A)

since fixed term deposit is a capital asset under section 11, read with section 2(14), of the Income-tax Act, 1961. Further, the Calcutta High Court has held that even six months' limit is not required to treat an investment to be a capital asset in the case CIT v. Hindusthan Welfare Trust [1994] 206 ITR 138 (Cal.), it was held that the 6 months holding period for re-investment of capital gains was not a valid condition.

If the investments do not come with a direction to be a part of corpus, then also in our opinion, such investment will not be subject to 85% application in the year of receipt and shall be subject to conversion to section 11(5) compliant investment under section 13(1)(d) as discussed below, in the light of the CBDT Circular (supra) and the fact that a donation of a capital asset normally is treated a part of trust property and not income from trust property. It may be noted that under section 11, only income from trust property is envisaged to be applied for charitable purposes, though it includes voluntary contribution available for application.

Gold and Jewellery Received as Donation is a Capital Receipt

The Jodhpur Tribunal in case of I.T.O., Ward 2(2), Jodhpur Vs. Shri Sachyaya Mataji Trust, Jodhpur, I.T.A. No.538/Jodh/2013 for the assessment year 2009-10 has held that voluntarily contribution-in-kind i.e. gold and jewellery received by the trust are not income for the purpose of Section. 12(1). It was observed that such voluntarily contribution-in-kind cannot be applied, accumulated or invested; therefore, it cannot be treated as income. The Tribunal further held that even under the provision of Clause (b)(iv) of third

proviso to Section. 10(23C), voluntary contribution received in-kind as gold and jewellery do not form the part of the income of the trust.

Applicability of Circular No. 580, Dated 14-9-1990

Certain funds, trusts and institutions running hospitals, crèches orphanages, school, etc., often receive donation-in-kind from various sources for application towards their charitable purposes. These contributions may be in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipments, etc.

Such donation-in-kind which can be used for charitable purposes/activities in the same form in which these are being received, shall be deemed to be applied for charitable purpose with the evidence of such use on the basis of Circular No.580, dated 14-09-1990. The text of the Circular is as under:

*"1. Under section 10(23C)(iv) and (v) of the Income-tax Act, income received by certain charitable and religious funds, trusts and institutions is exempt from tax, if the conditions specified for this purpose are satisfied. One such condition, as laid down in the third proviso to section 10(23C), is that the fund, trust or institution applies its income, or accumulates it for application, wholly and exclusively to the object for which it is established and it does not invest or deposit its funds (other than **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 of the Income-tax Act.

2. References have been received from various trusts and institutions pointing out that certain funds, trusts and institutions running hospitals, crèches, orphanages, schools, etc., and enjoying exemption under section 10(23C)(iv) or (v), of the Income-tax Act, often receive donations-in-kind from various sources for application towards their charitable purposes. These contributions may be in the shape of books, clothes for the poor, grains to feed the poor, drugs, hospital equipment, etc. It has been pointed out that all these are used as such for the purposes of the fund, trust or institution.

3. A doubt has, however, been raised as to whether the fund, trust or institution would be eligible for the tax exemption under section 10(23C)(iv) or (v) of the Act even if the donations-in-kind are not in the form of jewellery, furniture or any other article notified by the Board for the purposes of these provisions.

4. Since the donations-in-kind, of the nature referred to above, received by a fund, trust or institution, would be income within the meaning of section 2(24) of the Income-tax Act, it is clarified that use of these towards objects for which the fund, trust or institution is established would be regarded as application of income of the fund, trust or institution within the meaning of clause (a) of the third proviso to section 10(23C). Accordingly, the fund, trust or institution

would be eligible for the tax exemption, if the other conditions specified in section 10(23C)(iv) of the Income-tax Act are satisfied."

Applicability of above principle to Trusts registered under section 12AB:

The above circular was issued with reference to section 10(23C), but the same ratio should hold good even for 12AB registered organisation as long as the donation received in-kind are directly usable for charitable purposes in the form it is received and such use is established.

It may be noted that the voluntary contributions received and maintained in the form of jewellery as mentioned in the above circular only applies in context of clause (b)(iv) of third proviso to section 10(23C). However, such exclusion of donation-in-kind in the form of jewellery has not been mentioned anywhere under section 11. However, any contribution received in the form of jewellery or such other capital asset should be treated as a legal obligation for the purposes of section 2(24) (ia) and should not be treated as a part of income unless it is in the form of a investment which can be liquidated.

Treatment of Donation-in-Kind of the Assets in Permissible Mode as per Section 11(5)

Donation received by a trust may include Mutual Funds Investment, Bonds with PSUs, Immovable Property etc. which are all permissible modes of investment under section 11(5). Then only income from such investment shall be required to be applied for charitable purposes. It may be noted that in the light of CBDT Instruction No. 883, dated 24-9-1975, such investments should have a tenure of more than 6 months to be considered as

capital assets. If the investments gets liquidated within a period of less than six months, then such investment should not be treated as capital asset.

In our considered view, any investment received in-kind which gets liquidated within the impugned financial year, then the amount so received then such amount should be treated as income subject to 85% application, unless it is specifically provided towards the corpus.

Treatment of Donation-in-Kind of Assets in Impermissible Mode as per Section 11(5)

Donation-in-kind of assets in the form of impermissible mode of investment as per Section 11(5) may include shares, debenture of a company or jewellery to a charitable institution. Such donations are subject to Section 13(1)(d) which requires the funds are to be invested or held or deposited after 28-2-1983 in any mode as specified under section 11(5) of the Act and any violation thereof shall result into taxation of the amount of income equivalent to the amount of investment @ 30% u/s 115BBI.

Time line to convert within one year from the end of financial year in which such donation has been received: Any donation received in-kind which are in impermissible mode specified under section 11(5), then the same should be converted in any of the permissible forms or modes specified in subsection (5) of section 11, within 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.

It is to be noted that the explanatory notes issued in 1991 against insertion of proviso (iia) to section 13(1)(d) vide Circular No: 621 dated 19-12-1991 states as under:

"Further, a new clause (iia) has been inserted in the proviso in clause (d) of subsection (1) of section 13 to secure that mere accretion to the existing holding of shares by way of bonus shares or acceptance of donations in kind or any asset not conforming to the provision of section 11(5) will not make the fund or trust or institution lose tax exemption. The trusts or institutions will, however, be required to dispose or convert the assets not conforming to the requirement of section 11(5) into permissible investment within one year from the end of the financial year in which such bonus shares or other assets are received or 31-3-1992, whichever is later."

Hence, treatment of donation of shares or other impermissible mode has specifically dealt in by exemption to section 13(1)(d) and therefore, if the recipient organization converts into permissible mode within the specified time line then there should not be any tax implication.

Interplay Between Section 11(1)(d) as Amended by Finance Act, 2021 and Exception to Section 13(1)(d)

It is to be noted that after the amendment by Finance Act, 2021, the corpus donation shall be exempt u/s 11(1)(d) subject to the condition that such voluntary contributions are invested or deposited in one or more of the forms or modes specified in subsection (5) maintained specifically for such corpus. In

other words, the organisation has to invest the funds received as corpus donation in a more specified under section 11(5).

However, if the organisation receives investments which are not specified under section 11(5), then the concerned organisation should convert the investments into compliant mode within the expiry of one-year from the end of the previous year in which such asset is acquired as per exception to Section 13(1)(d).

Donation-in-Kind and Non-Applicability of Section 80G

Donation-in-kind are not subject to benefit of Sec. 80G and therefore, the donor is not eligible to claim any deduction u/s 80G if the donations are made in kind. Explanation-5 to section 80G clearly provides that benefit under section 80G shall not be available unless the donation is received in the form of money. This explanation which was inserted by the Finance Act, 1976, w.e.f. 01-04-1976 is reproduced as under:

"For the removal of doubts, it is hereby declared that no deduction shall be allowed under this section in respect of any donation unless such donation is of a sum of money."

The language used in section 80G(2)(a) is clear and unambiguous. The use of the expression 'any sums paid' contemplates payment of an amount of money. One of the dictionary meanings of the expression 'sum' means any indefinite amount of money. The context in which the expression 'sums paid by the assessee' has been used makes the legislative intent clear that it refers to the amount of money paid by the assessee as donation.

Therefore, for purposes of claiming deduction from income-tax under section 80G(2)(a), the donation must be a sum of money paid by the assessee.

The Supreme Court judgement in case of **H.H. Sri Rama Verma v. Commissioner of Income-tax** 1991 [187 ITR 308 SC] confirms the above view. The relevant portion of the judgement has been reproduced as under:

"The assessee-company donated certain shares to two charitable trusts. The ITO, however, rejected the assessee's claim for deduction of the donations under section 80G. The Tribunal held that the expression 'sums' occurring in section 80G did not include any donation made in kind in the shape of shares. On a reference, the High Court agreed with the view taken by the Tribunal. On appeal by certificate under section 261: HELD The language used in section 80G(2)(a) is clear and unambiguous. The use of the expression 'any sums paid' contemplates payment of an amount of money. One of the dictionary meanings of the expression 'sum' means any indefinite amount of money. The context in which the expression 'sums paid by the assessee' has been used makes the legislative intent clear that it refers to the amount of money paid by the assessee as donation. The Act provides for assessment of tax on the income derived by an assessee during the assessment years; the income relates to the amount of money earned or received by an assessee. Therefore, for purposes of claiming deduction from income-tax under section 80G(2)(a), the donation must be a sum of money paid by the assessee. The plain meaning of the words used in the section

does contemplate donations in kind. Since the expression and language used in section 80G(2)(a) is plain and clear, it is not open to the courts to enlarge the scope by its interpretative process founded on the basis of the object and purpose underlying the provisions for granting relief to an assessee.

Further, in view of the conflicting opinions expressed by the various High Courts, the Parliament intervened and added Explanation 5 to section 80G by the Finance Act, 1976. After the insertion of the aforesaid Explanation, there cannot be any doubt that, for purposes of claiming deduction, only cash amounts which may have been donated would be taken into account. No doubt this provision is not retrospective in nature; none the less it indicates the legislative intent behind section 80G(2)(a) even prior to its amendment. Therefore, the assessee's claim was rightly rejected."

Payment made directly to the supplier to supply goods is eligible for 80G: To achieve efficiency of expense incurred, the donors are nowadays making direct payment to vendors. Donors are either procuring the goods and then donating to Charitable Trusts or making payment to vendors as selected by donee. It has been held that such purchase/payment to vendor will constitute donation eligible for benefit under Section 80G. The ITAT of Jaipur in the case *Nash Fashions (India) Ltd. Vs. Deputy Commissioner of Income Tax ITA. No. 346/JP/2018*, dated 1st October 2018, held that such donation will be eligible

for 80G benefit even if the invoice is drawn in the name of donor. However, there could be various scenarios which are discussed below:

- where the assessee has an existing asset/property/stock-in-trade in its possession/control and the same is thereafter transferred by way of donation, it will be a clear case of donation-in-kind and the same will not be eligible for deduction.
- where the assessee purchases any asset/property/equipments, etc., from a third party and thereafter, the same is donated. Once the assessee has purchased/acquired the asset/property/equipment, the title/ownership in such asset/property/equipment has been transferred by way of gift. The gift in such cases is thus gift in kind and the same won't be eligible for deduction unless the donee organisation identifies the vendor directly collects the goods and only payment is made by the donor as discussed below.
- Sometimes where there is a necessity/requirement of certain asset/property/equipment by the donee institution and it reaches out to the donor to fund such acquisition/purchase of asset/property/equipment. In this case, the donee institution places the order directly on the supplier of the asset/property/equipment, thereafter, the supplier supplies the equipment directly to the donee and install the same at the premises of the donee institution. This will qualify for deduction as what has been spent and transferred is sum of money and not property in kind.

NPO Taxation - Anonymous Donations

Overview

The Finance Act, 2006 had brought radical changes with regard to treatment of anonymous donations received by charitable organisations. A new section 115BBC was inserted w.e.f. 1-4-2007, whereby anonymous donation is taxable at the rate of 30% without any deduction or set off under any other head.

The Finance (No. 2) Act, 2009, w.e.f. 1-4-2010 provided some relief by exempting anonymous donations to the extent of 5% of total donations received or Rs.1 lakh, whichever is higher.

Section 115BBC covers only university or other educational institution referred to in sub-clause (iiia), or sub-clause (vi), or any hospital or other institution referred to in sub-clause (iiia), or sub-clause (via), or any fund or institution referred to in sub-clause (iv), or any trust or institution referred to in sub-clause (v) of clause (23C) of section 10 or any trust or institution referred to in section 11.

The education/medical institutions substantially financed by the government [section 10(23C)(iiia) & (iiic)] and institutions under section 10(46) & 10(46A).

Religious organisations have been kept outside the purview of this provision. In other words, any anonymous donation received by a trust or an institution created wholly for religious purposes shall not be covered by these provisions.

In the case of partly religious and partly charitable institutions, anonymous donations directed towards a medical or educational institution run by such entities shall be covered as anonymous donations. Other donations to partly religious and partly charitable institutions shall remain exempt from taxation by virtue of the clarification provided by CBDT's explanatory Circular No. 5/2010, dated 3-6-2010 on section 115BBC.

Exemptions available under section 11 are not available to the taxable portion of anonymous donations and they are to be taxed as per the provisions of section 115BBC. Therefore, the condition relating to the application and accumulation of income would not apply to the taxable portion of anonymous donations. Therefore, anonymous donations shall not be subject to 85% application for charitable purposes. In other words, anonymous donations, subjected to tax, can be accumulated indefinitely. It may be noted that the exempted portion of anonymous donation shall be subject to 85% application along with other incomes.

Anonymous donation means any voluntary contribution referred to in sub-clause (ia) of clause (24) of section 2, where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as may be prescribed. It is to be noted that such particulars as mentioned are yet to be prescribed.

Anonymous donations to the extent of 5% of total donations or Rs.1 lakh, whichever is higher, are exempt as an anonymous donation and are therefore not subject to 30% tax. However, the exempted portion shall form part of the income subject to application under section 11 of the Income-tax Act.

Taxable portion of the anonymous donation is subject to tax @ 30%. Exemptions available under section 11 are not available to the taxable portion of anonymous donations and they are to be taxed as per the provisions of section 115BBC. This part of income can therefore be accumulated indefinitely.

The amount collected from donation boxes should not be considered as an anonymous donation, subject to specific facts and circumstances.

There is a preponderance of judicial precedence that section 68 shall not apply to charitable institutions receiving the anonymous donation.

The High Court of Delhi in the case of *The Commissioner of Income Tax (Exemptions) v. Patanjali Yogpeeth (NYAS)* ITA 886/2017 held that donations collected through sale of coupon from various yoga camp shall not be treated as anonymous based on the affidavits of the President of the camp and the video footage available. In other words, even in the absence of the name and address of the donor, an affidavit by the organisation and corroborative evidence shall be admissible.

In the case of partly religious and partly charitable institutions, anonymous donations shall be exempt from tax unless such donation is directed towards a medical or educational institution run by such entities, and shall be taxable only to the extent such donations exceed 5% of total donations received by such trust or institution or a sum of Rs.1 lakh,

whichever is more. Other donations to partly religious and partly charitable institutions shall remain exempt from taxation.

Legal Provisions

Section 12(1) was inserted with effect from 1-4-1973 based on the recommendation of the Wanchoo Committee. One of the observations of Wanchoo Committee was that anonymous donation should not be allowed exemption to curtail the menace of black money. The Wanchoo Committee recommended that all anonymous donations to charitable trust should be taxed at the rate of 65%. However, the Select Committee of the Parliament did not accept these recommendations of the Wanchoo Committee. It opined that no objection should be made to anonymous donation if it is spent for charitable or religious purposes. It was further observed that, in India, many donors do not like to disclose their identity due to spiritual traditions. Further, donations collected through charity boxes would also come under trouble as it is difficult to establish the identity. The ghost of the Wanchoo Committee seems to have been resurrected in the Finance Act, 2006, as a new section 115BBC was inserted, which proposed to tax anonymous donations at a rate of 30%.

The Finance Act, 2006 had brought in radical changes with regard to anonymous donations received by charitable organisations. A new section 115BBC was inserted w.e.f. 1-4-2007 whereby anonymous donations are taxable at the rate of 30% without any deduction or set-off under any other head. This amendment caused harassment to many genuine voluntary organisations that received anonymous donations through donation boxes and various other sources. The Finance Act, 2009 brought some relief to the taxation of anonymous donations by providing some relief to such organisations as, at least, anonymous donation

up to 5% of total donations or Rs.1 lakh whichever is higher was exempted from taxation.

What Are Anonymous Donations

Section 115BBC(3), defines "anonymous donation" as a voluntary contribution mentioned in sub-clause (iia) of clause (24) of section 2, where the recipient of the contribution does not keep a record of the contributor's identity, including their name, address, and any other details that may be specified.

It is worth noting that at present, there are no prescribed additional details. Therefore, a donation is considered anonymous only if it is a voluntary contribution and the recipient does not keep a record of the contributor's identity, including their name and address.

The Finance Act, 2022 has introduced additional requirements to maintain books of account by the trusts and institutions under section 12(1)(b)(i) with effect from the assessment year 2023-24. Furthermore, Sections 13(10) and 13(11) were inserted to provide that if the trust or institution has not maintained the books of account, the income chargeable to tax shall be computed after allowing a deduction for only those expenditures specified in these sections.

To comply with these requirements, the CBDT has notified Rule 17AA through Notification No. 94/2022 dated 10-08-2022, which outlines the books and documents to be maintained by entities approved under Section 10(23C) or registered under Section 12AB. The rule specifies that trusts or institutions should maintain the following records of voluntary contributions, including corpus:

(a) Name of the donor;

(b) Address;

(c) Permanent account number (if available); and

(d) Aadhaar number (if available).

Therefore, the aforementioned rule necessitates the retention of not only the donor's name and address but also their PAN and Aadhaar details in records, if available.

Only Name and Address To Be Produced

In the case of *Hans Raj Samarak Society v. Asstt. DIT* [2011] 16 taxmann.com 103/ 133 ITD 530 (Delhi - Trib.), it was held that the assessee was not required to maintain anything more than the name and address of the donor as it prescribed in section 115BBC(3). This ruling is very significant as it clarifies the limitations of the AO to call for information or additional evidence in case of anonymous donation. Section 115BBC(3) provides that the receiver has an obligation to maintain the identity indicating the name and address of the donor and such other particulars as may be prescribed. No other particular has been prescribed under this provision or elsewhere in the Act or Rules. The Delhi ITAT ruled that the expression of a valid voluntary contribution has been defined in an exhaustive manner and, therefore, no other word can be read in section 115BBC(3) other than the words finding place therein.

However, in the case of *Shri Girraj Educational and Welfare Society v. ITO* [2012] 27 taxmann.com 89/[2013] 56 SOT 428 (Agra - Trib.), it was held that in view of failure of assessee-society to maintain proper records indicating names and address of donors, voluntary contributions received by it were rightly brought to tax as anonymous donations within meaning of section 115BBC.

In the case of *M/s. Ramadevi Memorial Charitable Trust v. The ACIT(E), Jaipur* [ITA No. 1023/Jp/2016, dated 7-2-2020] - ITAT Jaipur held that where proper name and address were not available and the donation were of identical amount of Rs.5,000, the Assessing Officer was justified in taxing it as anonymous donation.

The ITAT Visakhapatnam Bench in the case of *Assistant Commissioner of Income Tax Vs. Siddhartha Academy of General & Technical Education* [2022] 141 taxmann.com 287 (Visakhapatnam - Trib.) held that where assessee-trust provided details of donors along with names and addresses and furthermore, confirmation letters from donors were also provided to Assessing Officer in respect of donation received, mere absence of PAN in confirmation letters of donors would not give rise to suspicion that they were anonymous donations; maintenance of name and address details of contributors would be a sufficient document to establish identity of donors as prescribed under section 115BBC.

Taxability of Anonymous Donations

Section 115BBC(1) provides as under: Where the total income of an assessee, being a person in receipt of income on behalf of any university or other educational institution referred to in sub-clause (iiiad) or sub-clause (vi) or any hospital or other institution referred to in sub-clause (iiiad) or sub-clause (via) or any fund or institution referred to in sub-clause (iv) or any trust or institution referred to in sub-clause (v) of clause (23C) of section 10 or any trust or institution referred to in section 11, includes any income by way of any anonymous donation, the income-tax payable shall be the aggregate of-

- (i) the amount of income-tax calculated at the rate of thirty per cent on the aggregate of anonymous donations received in excess of the higher of the following namely:
 - (A) five per cent of the total donations received by the assessee, or
 - (B) one lakh rupees, and
- (ii) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of anonymous donations received in excess of the amount referred to in sub-clause (A) or sub-clause (B) of clause (i), as the case may be.

Therefore, the following entities are liable to pay tax on the anonymous donation:

- (a) A trust or institution as referred to in Section 11;
- (b) University or educational institutions whose annual receipts do not exceed Rs 5 crores [Section 10(23C)(iiiad)];
- (c) University or educational institution whose annual receipts exceed Rs.5 crore and it is approved by the Principal Commissioner or Commissioner. This does not include an university or educational institution which are financed, wholly or substantially, by the government [Section 10(23C)(vi)];
- (d) Hospital or medical institution whose annual receipts do not exceed Rs 5 crores [Section 10(23C)(iiiad)];

- (e) Hospital or medical institution whose annual receipts exceed Rs.5 crores and it is approved by the principal commissioner or commissioner. This does not include a hospital or institution which is financed, wholly or substantially, by the Government [Section 10(23C)(iv)];
- (f) Any fund or institution, established for charitable purposes and notified by the Central Government, having regard to the objects of the fund or institution and its importance throughout India or any State [Section 10(23C)(iv)];
- (g) Any trust or institution wholly for public religious purposes or wholly for public religious & charitable purposes and notified by the Central Government with a view to ensure that the income accruing thereto is properly applied for the objects thereof [Section 10(23C)(v)].
- (i) any trust or institution created or established wholly for religious purposes;
- (ii) any trust or institution created or established wholly for religious and charitable purposes other than 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.

Summary of Exclusions

Anonymous donations received by wholly religious institutions shall remain exempt from tax.

In the case of partly religious and partly charitable institutions, anonymous donations directed towards a medical or educational institution run by such entities shall be covered as anonymous donation, though taxable only to the extent such donations exceed 5 per cent of total donations of such trust or institution or a sum of Rs.1 lakh, whichever is more. Other donations to partly religious and partly charitable institutions shall remain exempt from the purview of this provision.

In the case of wholly charitable institutions, anonymous donations shall be taxable to the extent such donations exceed 5 per cent of total donations of such trusts/institutions or a sum of Rs.1 lakh, whichever is more.

The above clause provides that anonymous donations received by religious and charitable trusts would be taxable if received with a specific direction that such donation is for any university, educational institution or medical institution. It is not clear how a specific direction can come from anonymity. Suppose such directions are valid without knowing the

Hence, it should be noted that entities other than those specified above are not included in its scope. Specifically, educational and medical institutions that are substantially financed by the Government (as defined under section 10(23C)(iiiab) and (iiiic), as well as institutions that have been notified under section 10(46) and 10(46A) of the Income-tax Act, are exempt from the provisions of section 115BBC.

Exclusion from Taxability

Section 115BBC(2) further provides that provision of anonymous donation shall also not apply to any donation received by:

identity of the donor, in that case, a trust may also contend that the anonymous donations are restricted donations and therefore not a part of its income as they could not be treated as a voluntary contribution under section 12(1) or section 2(24)(ia).

CBDT's Circular Exempting Partly Charitable and Partly Religious Organisation

CBDT has issued an explanatory circular regarding section 115BBC No. 5/2010, dated 3-6-2010. The scope and effect of the amendments [w.e.f. 1-4-2010] made to section 115BBC have been explained in this circular. Further, it has been provided that donations to partly religious and partly charitable institutions shall remain exempt from taxation except anonymous donations directed towards a medical or educational institution run by such entities.

Scheme of Taxation of Anonymous Donations

The donations are taxable under this provision only if the amount of anonymous donations exceeds higher of the following limit:

- (a) Rs. 1 lakh; or
- (b) 5% of total donation received.

The tax shall be levied only on the amount which exceeds higher of the above referred limit.

Provisions for Taxation of Anonymous Donations Explained by CBDT Circular

The CBDT circular no. 14 dated 28-12-2006 explains the provisions of section 115BBC, as follows:

"With a view to prevent channelisation of unaccounted money to these institutions by way of anonymous donations, a new section 115BBC has been inserted to provide that any income of a wholly charitable trust or institution by way of anonymous donation shall be included in its total income and taxed at the rate of 30 per cent. Anonymous donation made to wholly charitable and religious trusts or institutions, i.e. mixed purpose trusts or institutions shall be taxed only if it is for any university or other educational institution or any hospital or other medical institution run by them. Anonymous donation to wholly religious trusts or institutions will not be taxed.

Anonymous donation has been defined in the new section to mean any voluntary contribution referred to in section 2(24)(ia) of the Act, where a person receiving such contribution does not maintain a record of the identity indicating the name and address of the person making such contribution and such other particulars as maybe prescribed. Consequential amendments have been made in section 10(23C) and section 13 to provide that any income by way of any anonymous donation which is taxable under section 115BBC, shall be included in the total income of the assessee."

Taxability of Exempted Portion of Anonymous Donation

There was a clarifying amendment in the Finance (No. 2) Act, 2014, with regard to the computation of tax liability in the case of Anonymous Donations. The amendment provided that while computing the tax liability of the total income, instead of excluding the entire amount of anonymous donations, only the amount in excess of 5% of total donations or Rs.1 lakh, whichever is higher, should be deducted. This amendment removes the anomaly, as currently, anonymous donation upto Rs.1 lakh or 5%, whichever is higher, is not subject to tax.

However, the exempted portion shall form part of income subject to application under section 11 of the Income Tax Act.

Whether A Taxable Portion of Anonymous Donations are Subject to Conditions as to Application and Accumulation?

After the insertion of section 115BBC regarding taxation of anonymous donations, no amendment was made to sections 11 and 12, which create confusion about whether anonymous donations are subject to application and accumulation. However, a new sub-section (7) has been added to section 13, which provides that nothing contained in sections 11 or 12 shall operate to exclude anonymous donations from total income. The text is as under:

"(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."

In other words, any portion of anonymous donations that is subject to taxation under section 115BBC cannot be exempted under the provisions of section 11. Therefore, such donations are subject to tax as per the guidelines specified under section 115BBC. As a result, the requirements related to the utilization and accumulation of income that are applicable to charitable organizations under section 11 would not apply to the taxable portion of anonymous donations. This means that the 85% mandatory application for charitable purposes would not be applicable to the taxable portion of anonymous donations. However, the exempted portion of anonymous donations would still be subject to the mandatory 85% application for charitable purposes.

Whether Anonymous Donations in the Nature of Project Donations are Hit by Section 115BBC?

As discussed in preceding chapters, project donations are generally considered a part of income unless they can be shown to be non voluntary and restricted funds. However, in order to demonstrate that a donation is intended for a particular project, it must be accompanied by specific instructions from the donor. This can be challenging in the case of anonymous donations, as it is difficult to prove that such donations are restricted and intended for a specific purpose.

In this regard, sub-section (2)(b) of section 115BBC creates further confusion which provides as under:

"(b) any trust or institution created or established wholly for religious and charitable purposes other than 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."

The aforementioned clause states that anonymous donations received by religious and charitable trusts will be subject to taxation if they are accompanied by specific instructions indicating that the donation is intended for a university, educational institution, or medical institution. However, it is unclear how specific instructions can be attributed to an anonymous donor.

Suppose such directions are valid without knowing the identity of the donor. In that case, a trust may also contend that the anonymous donations are restricted donations and, therefore, not a part of its income as they could not be treated as a voluntary contribution under section 12(1) or section 2(24)(ia).

However, specific direction from an anonymous donor may not be a legally tenable position either way. Therefore, sub-section (2)(b) of section 115BBC needs to be amended appropriately. Amidst the confusion and lack of clarity, it seems that anonymous donations, irrespective of the nature, would be hit by section 115BBC.

If Section 13 is Violated, Whether Anonymous Donations will be Taxed Again?

The question arises whether anonymous donations would be taxed again in case there is a violation under section 13. A plain reading of section 13(1) and section 13(7) implies that anonymous donations have been excluded from the purview of sections 11 and 12. Any violation under section 13 results in a forfeiture of the exemptions available under sections 11 and 12. Under such circumstances, double taxation of anonymous donations does not look tenable as it does not enjoy any exemption under sections 11 or 12.

Apart from the above analysis, it has been held by Supreme Court on several occasions that income cannot be taxed twice. Double taxation is possible only if the Legislature has distinctly enacted it. In the case of *LaxmipatSinghania v. CIT* [1969] 72 ITR 291, the Supreme Court observed that it is a fundamental rule that income cannot be taxed twice unless otherwise expressly provided. In another case of *Jain Bros. v. Union of India* [1970] 77 ITR 107, the Supreme Court observed that as such, there is no constitutional bar on double taxation, but for that, the legislature should expressly enact provision for such double taxation.

In light of the above case studies, in our opinion, anonymous donations, once taxed under section 115BBC, would not be subject to double taxation even in case of a violation under section 13.

Anonymous Donation is Different from Unaccounted Donations

Anonymous donation is different from unaccounted donation. In case of anonymous donation, the donations are on record but donors are not traceable. However, unaccounted donations may attract the provisions of section 13(1)(c). In the case of *Vidyavardhini v. Asstt. CIT, Central Circle-2, Thane* [2012] 20 taxmann.com 81/51 SOT 17 (Mum.) (URO), it was held that since trust is an artificial judicial person and has to act through trustees or anybody authorized by trustees, acts of trustees or person so authorized have to be considered as acts on behalf of trust. Therefore, considering material on record and entire surrounding circumstances, it was to be held that unaccounted donations collected by Secretary were on instructions of trustees on behalf of trust and had been rightly assessed as income of assessee trust. It was further held that having regard to fact that donations were not accounted in books of assessee trust and had been used by trustees and secretary who were persons specified in section 13(3), provisions of section 13(1)(c) were applicable and exemption under section 11 would not be available.

Anonymous Donation can Attract Money Laundering Act

It is worth noting that all non-governmental organizations (NGOs) and religious institutions have been brought under the ambit of the Prevention of Money Laundering Act (PMLA) 2002 through an amendment that was published in the Official Gazette on November 12, 2009. This means that it may not be feasible for these organizations to accept large anonymous donations since the PMLA mandates the disclosure of donor details, particularly in the case of foreign donations. As a result, religious organizations that are not covered under section 115BBC

may also fall under the purview of the Money-Laundering Act, thereby making it necessary for them to adhere to the disclosure requirements stipulated by the Act.

The notification S.O. 1074(E) [F. NO. P-12011/12/2022-ES CELL-DOR], dated 7-3-2023, announces amendments to Rules 2, 3, and 9 of the Prevention of Money Laundering (Maintenance of Records) Amendment Rules, 2023.

The Ministry of Finance, vide the above-mentioned notification, has recently issued amendments to the Prevention of Money-laundering (Maintenance of Records) Rules, which broaden the scope of compliance for non-government organisations (NGOs), politicians, and financial institutions. The gazette notification specifies several changes, such as the addition of a clause defining politically exposed persons (PEPs), as well as a requirement for banks, financial institutions, and intermediaries to register an NGO's details on the Darpan portal of NITI Aayog, if not previously done.

The new rules require banks to maintain records on the nature and value of transactions carried out by individuals and NGOs, and also specify the procedures for sharing this information, the duration for which the data will be retained, and the manner in which identity records of such clients will be maintained by banking companies, financial institutions, and intermediaries.

In addition, the rules impose additional data retention requirements on NGOs. Specifically, every banking company or financial institution must register the details of such a client on the DARPAN Portal of Niti Aayog, and if the records have not already been registered, they must be maintained for a period of five years after the business relationship between a client and a reporting entity has ended, or the

account has been closed, whichever is later.

Assessing Officer cannot Declare A Donation as Anonymous by Merely Examining A Few Donors - Cross-Examination is Also Necessary

In the case of CIT v. Geetanjali Education Society [2008] 174 Taxman 440 (Raj.), it was held that the Assessing Officer cannot declare the donations as anonymous or bogus, as some of them were not examined nor those who were examined had been allowed to be cross-examined. Therefore, any donation given in favour of the society could not have been held to be bogus without examining the donors and subjecting them to cross-examination.

Burden of Proof is Entirely on the Assessee to Establish the Identity of the Donors

The ITAT Bombay Bench in the case of Madhavi Raksha Sankalp Nirmal Niketan v. Dy. CIT [2017] 83 taxmann.com 316/165 ITD 627 (Mum. - Trib), that the onus as well burden of proof is entirely on the assessee to provide to the AO all relevant details as contemplated u/s 115BBC to the satisfaction of the AO as to compliance of section 115BBC and as to genuineness of the said donation and if the assessee failed to do so, the entire transaction was hit by provisions of section 115BBC.

Small Collection Through Donation Boxes is Not Covered

The issue of anonymous donation was also considered by the ITAT, Amritsar Bench's decision in the case of Dy. CIT v. All India Pingalwara Charitable Society [2016] 158 ITD 410/67 taxmann.com 338 (Asr.- Trib.), where the ITAT held that the intent of section 115BBC was to tax unaccounted money, but it was never intended to tax small and petty collections through donation boxes.

In the case of Gurudev Siddha Peeth, Shrish Thakkar v. ITO, Ward-1 (1), Kalyan 59 taxmann.com 400 (Mumbai - Trib.), held that in the case of a religious or charitable trust, it is generally not only difficult but also not possible to maintain such type of record. A perusal of the entire section 115BBC shows that the provisions of said section are not applicable to the institutions like that of assessee trust, as the same are meant to check the inflow of unaccounted/black money into the system with a modus operandi to make out as a part of the accounts of the institutions like university, medical institutions where the problem relating to the receipt of capitation fees, etc. is generally highlighted. Under such circumstances, we do not find any justification in taxing the offerings received in the hundis/donation boxes as income of the assessee under section 115BBC.

In the case of ITO (E)-I(1), Mumbai v. Bombay Panjrapole [ITA No. 5414/M/2010,

dated 25-7-2012] ITAT Mumbai held that in case of a charitable trust engaged in maintaining gaushalas and veterinary hospital for treatment of wounded and sick animals and birds, the donations received from public through donation boxes could not be taxed under 115BBC.

Affidavit and Video Footage Admissible as Evidence for Donation

The High Court of Delhi, in the case of The Commissioner of Income Tax (Exemptions) v. Patanjali Yogpeeth (NYAS) ITA 886/2017, held that donations collected through sale of coupon from various yoga camp shall not be treated as anonymous based on the affidavits of the President of the camp and the video footage available. In other words, even in the absence of the name and address of the donor, an affidavit by the organisation and corroborative evidence shall be admissible.

Budget 2023 - Summary of Major Amendments for NPOs

Introduction

The Finance Bill 2023 has brought in various amendments for charitable and religious organisations. There are some amendments which will have far reaching implications on the charity sector. The amendments pertain to various aspects including registration, cancellation, new norms for claiming applications etc. have been provided in this article.

The amendments have been proposed for organisations registered/approved under section 12AB as well as section 10(23C) except in the case of withdrawal of retrospective tax benefits under provisos to section 12A(2) as such benefit was available only to organisations registered under section 12AB.

Application Out of Corpus Fund

Background and the existing law: Two years ago, the Finance Act 2021 had provided that any expenditure or application made out of the corpus fund or donation will not be allowed as application for charitable or religious purposes eligible for 85% application. Such amount shall be allowed as application in the year in which it is deposited back to corpus to the extent of such deposit or investment.

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that instances were observed where application out of corpus has already been claimed as application prior to

01/04/2021 and therefore allowing such application again on replenishment of corpus will tantamount to double deduction and at the same time availability of indefinite period of replenishment will make the implementation of provision quite difficult. It is also equally important to understand the applications made out of corpus are the eligible application without any specified disallowance.

Proposed Amendments by Finance Bill 2023:

- It is proposed that any application made out of corpus can be offset against future years' income for a period of five years from the end of the year in which such corpus was applied for charitable purposes.
- It is further provided that this provision shall apply to all the application made from corpus on or after 1st April 2021.
- It is also provided that conditions that are required to be satisfied in the case of an application for charitable or religious purposes must also be satisfied while making the application from the corpus.

Therefore, the restoration of corpus shall only be considered as an application if the following conditions were satisfied at the time of making the application from the corpus :

- (a) Such application should not be in the form of a corpus donation to another trust;

- (b) TDS, if applicable, should be deducted on such application;
- (c) Where payment or aggregate of payments made to a person in a day exceeds Rs. 10,000 in other than specified modes (such as cash) is not allowed;
- (d) Application is allowed in the year in which it is actually paid;
- (e) Application should not directly or indirectly benefit any person referred to in Section 13(1) and the income of the trust or institution should not ensure any benefit to such person;
- (f) Application should be in India except with the approval of the Board in accordance with the provisions of Section 11(1)(c).

Implication & Issues arising out of it:

The application upto 31st March 2021 out of corpus fund and irrespective of the fact that such application was claimed as application in the respective year or not will not be allowed to set off against any future year income w.e.f 01.04.2023. Therefore, an organisation has been sustaining its activity out of corpus fund up to 31st March 2021 and was not able to replenish its corpus on or before 31st March 2022, then such organisation will erode its corpus to that extent. This amendment defies the intent of the Memorandum explaining the Finance bill 2023 which mentioned the need of this amendment is to prohibit double deduction of the amount of application.

Further, the five-year limit for reclaiming the corpus may have very adverse impact on many institutions which have a long gestation period or are compelled to continue their activities

from corpus for multiple years.

Again it shall be very important to keep track of amount of eligible application satisfying the specified conditions and its disclosure by way of Notes to accounts to bring clarity.

APPLICATION OUT OF LOAN AND BORROWINGS

Background and the existing law: Two years ago, the Finance Act 2021 had provided that any expenditure or application made out of the loan and borrowings will not be allowed as application for charitable or religious purposes eligible for 85% application. Such amount shall be allowed as application in the year in which the repayment of such loan and borrowings, to the extent of such repayment.

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that instances were observed where application out of loan has already been claimed as application prior to 01/04/2021 and therefore, allowing such application again on repayment of loan will tantamount to double deduction and at the same time availability of indefinite period of repayment will make the implementation of provision quite difficult. It is also equally important to understand the applications made out of loan are the eligible application without any specified disallowance.

Proposed Amendments by Finance Bill 2023:

- It is proposed that any application made out of loan can be offset against future years' income for a period of five years from the end of the year in which such loan was applied for charitable purposes.

- It is further provided that this provision shall apply to all the application made from loan on or after 1st April 2021.
- It is also provided that conditions that are required to be satisfied in the case of an application for charitable or religious purposes must also be satisfied while making the application out of the loan. Therefore, the repayment of loan shall only be considered as an application if the following conditions were satisfied at the time of making the application from the loan:
 - (a) Such application should not be in the form of a corpus donation to another trust;
 - (b) TDS, if applicable, should be deducted on such application;
 - (c) Where payment or aggregate of payments made to a person in a day exceeds Rs. 10,000 in other than specified modes (such as cash) is not allowed;
 - (d) Application is allowed in the year in which it is actually paid;
 - (e) Application should not directly or indirectly benefit any person referred to in Section 13(1) and the income of the trust or institution should not ensure any benefit to such person;
 - (f) Application should be in India except with the approval of the Board in accordance with the provisions of Section 11(1)(c).

Implication & Issues arising out of it: The application upto 31st March 2021 out of

loan and irrespective of the fact that such application was claimed as application in the respective year or not will not be allowed to set off against any future year income w.e.f 01.04.2023. This amendment defies the intent of the Memorandum explaining the Finance bill 2023 which mentioned the need of this amendment is to prohibit double deduction of the amount of application.

Further, the five-year limit for repayment of loan may have very adverse impact on many institutions which have a long gestation period or are compelled to continue their activities from loan for multiple years

Again, it shall be very important to keep track of amount of eligible application satisfying the specified conditions and its disclosure by way of Notes to accounts to bring clarity.

R E T R O S P E C T I V E EXEMPTIONS BENEFIT WITHDRAWN

Background and the existing law: All organisations registered under section 12AB at the privilege of tax exemptions for a period prior to the date of registration. In other words, once an organisation was registered under section 12AB (earlier section 12AA), then the Act provided that all open assessment pending before assessing officer will be made by giving the benefit of exemptions under section 11 to the organisation. This privilege was provided under proviso two, three and four to section 12A(2). These provisos were inserted by Finance Act 2014 to protect organisations at the time of applying for 12A registration from tax demands for earlier years. It was a great enabling provision which encouraged organisation to come forward for section 12AB registration without any fear for tax demands for earlier years.

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that as per the present scheme of provisional registration, an organisation can apply for registration before commencement of activities & therefore proviso allowing the benefit of earlier years has become redundant.

Proposed Amendments by Finance Bill 2023: It is proposed that the second, third and fourth provisos to sub section (2) of section 12A shall be omitted.

Implication & issues arising out of it: An organisation cannot claim exemptions earlier years. It will result in tax demands and litigations at the time of 12AB registration for existing organisation. If such organisation have excess of income over expenditure, then such excess shall be subject to tax. However, it has been seen that the Assessing Officer taxes the gross receipt of a charitable organisation which should not be done in the light of the Delhi High Court ruling in the case the Delhi High Court in the case Dy. DIT (E) v. Petroleum Sports Promotion Board [2014] 44 taxmann.com 322/223 Taxman, wherein it was held that application for charitable purposes should be allowed as expenditure even under section 56 and 57 for organisation not registered under section 12AB.

Currently an organisation was able to claim tax exempt status for the current and past assessment years by just obtaining for provisional registration under section 12AB. Further, these provisos were useful for new organisation with the rationale that once they are considered as genuine charitable organisation, they should not be asked for taxes for past years. This liberal and benevolent aspect of the law has been withdrawn. This amendment will also result in litigations at the

time of 12AB registration and will discourage organisations from applying for 12AB registration.

As the proviso has been deleted w.e.f. 01-04-2023, it implies that any assessment made on or from 1-04-2023 cannot give effect of this proviso because this proviso is no longer in the statute w.e.f. 01-04-2023. This will create a great hardship to all the registrations which have already been granted upto March, 2023 with a clear provision that such registration shall be subject to the benefit of the proviso allowing registration benefit for the earlier years. Hence, we understand it needs to be clarified that the registration obtaining on & before 31/03/2023 shall not be affected by this amendment.

INTER-CHARITY DONATION

Background and the existing law: As per the present scheme of taxation, an organisation is required to apply minimum 85% of the income for charitable or religious purposes. This mandatory 85% utilisation can either be done by the organisation directly or by donating to trusts with similar objectives. If donated to other trusts or institutions, the donation should not be towards corpus to ensure that the donee trust or institutions apply the donations. In other words, inter charity grant is treated as a valid application on par with direct application for the purposes of Sections 11(1)(a). It has been held in various cases that a donation made by one charitable organisation to another shall be considered an application for the purposes of Section 11(1)(a).

Therefore, as per the present law, the inter charity donation is considered as application without any restriction except contribution towards corpus.

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that instances were observed where, by formation of multiple layered trust & accumulation of 15% in each layer, the effect of application towards charitable purpose has reduced significantly and much less than the mandatory requirement of 85%.

Proposed Amendments by Finance Bill 2023: It is proposed that only 85% of the eligible donations made by an organisation registered under section 12AB or section 10(23C) to another similarly exempt organisation shall be treated as the application. In other words, if an organisation gives Rs. 100/- as grant to another organisation then only Rs. 85/- will be treated as application. The proposed amendment has been made by inserting the following provision :

“clause (iii) in Explanation 4 to sub section (1) of section 11 of the Act to provide that any amount credited or paid, other than the amount referred to in Explanation 2 to the said sub section, 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) of clause (23C) of section 10 of the Act or other trust or institution registered under section 12AB of the Act, as the case may be, shall be treated as application for charitable or religious purposes only to the extent of eighty-five per cent. of such amount credited or paid.”

This amendment will take effect from 1st April, 2024 and will accordingly apply in relation to the Assessment Year 2024-25 and subsequent assessment years. In other words, any contribution made after 1st April 2023 will be impacted.

Implication & Issues Arising Out of it: The implication of this amendment can be explained by way of following example :

Particulars	Present Position		As per proposed amendment	
	Amount (Rs.)	Amount (Rs.)	Amount (Rs.)	Amount (Rs.)
Computation of Income				
Income		100		100
Less: Inter-charity donation	80		68	
: Other Exp	5	85	5	73
Available Surplus		15		27
Less: Statutory Accumulation upto 15%		15		15
Surplus subject to tax by option/accumulation		NIL		12

- It is to be noted that Foreign Contribution (Regulation) Act already prohibits inter-charity grant out of FC fund and the proposed amendment will further impact all mother NGOs who basically channelize funds to smaller NGOs.
- It is also to be noted that indirectly these Mother NGO will not have the benefit of statutory accumulation of 15% once this amendment is passed.

Earlier, organisations were allowed to accumulate additional amount to their corpus with the help of other income. For example, the total income of an organisation is **Rs.1.20 crore** which includes **Rs.1.05 crore** received towards a partnership program with five other NGOs and **Rs.15 lakh** is its incidental income. The organisation gives **Rs.80 lakh** to other NGOs and spends directly **Rs.25 lakh** on the partnership program. In this case, under the existing provisions, the organisation have spent more than 85% of its total income by

spending **Rs.1.05 crore** but under the proposed provisions the application of the organisation will be **Rs.68 lakh** (85% of Rs. 80 lakh) and **Rs.25 lakh** i.e., **Rs.93 lakh** and it will have to spend another **Rs.9 lakh** of its incidental income which earlier was available for accumulation. To sum, the opportunity to create additional corpus has been plugged which will have major impact on large NGOs and corporate foundations.

BENEFIT OF EXEMPTION WILL NOT BE AVAILABLE ON FILING AN UPDATED RETURN OF INCOME

Background and the existing law: The entities registered under Section 12AB are required to file a return of income under Section 139(4A) if the total income, without giving effect to the provisions of Sections 11 and 12, exceeds the maximum amount not chargeable to tax. Similarly, to claim an exemption under Section 10(23C), the trust or institution must furnish the return of income for the previous year in accordance with provisions of Section 139(4C).

The Finance Act, 2022 had inserted subsection (8A) in Section 139 to enable filing an updated return. It provides that any person may file an updated return whether or not such a person has already filed the original, belated, or revised return for the relevant assessment year or not. Under section 12A(1)(ba) to avail exemptions under section 11 it is necessary to file return within the time allowed under section 139. In other words, the compliance of return filing would be fulfilled in all three circumstances:

- (i) normal return under section 139(1),
- (ii) belated return under section 139(4),
- (iii) updated return under section 139(8A).

In other words, under the existing law the exemptions of an organisation shall not be withdrawn (subject to other compliances) for filing a belated return under section 139(4) or a updated return under section 139(8A).

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that because of the present timeline of furnishing of return, the unintended benefit of exemption has also become available for the updated return furnished u/s. 139(8A)

Proposed Amendments by Finance Bill 2023: It proposes an amendment to the twentieth proviso to Section 10(23C) and Section 12A(1)(ba), providing that the return of income shall be filed within the time allowed under Section 139(1) or Section 139(4).

Implication & issues arising out of it: Organisations cannot claim the benefit of exemption if they file an updated return of income. The exemption shall be available only if the return of income is filed within the time allowed to file the original return of income under Section 139(1) or the belated return of income under Section 139(4).

It is to be noted that filing of updated return shall be considered as a non-compliance of condition under section 12A(1)(ba) and consequently section 13(10) and 13(11) shall be applicable. Section 13(10) and (11) provide for taxation where there are specified non compliances including the non compliance under section 12A(1)(ba).

TIME LIMIT FOR FILING OPTION & ACCUMULATION OF INCOME

Background and the existing law: A trust or institution is required to apply at least 85% of

its income for charitable/religious purposes every year. In case the trust is unable to apply 85% of its income, then the shortfall amount shall be considered as an application of income in the following situations;

- a. It can accumulate the shortfall to be used within the next 5 years. This accumulation is allowed if the assessing officer is informed about the purpose of the accumulation and the period for which the income is being accumulated. The information is to be furnished in Form 10 on or before the due date for furnishing the return of income under Section 139(1).
- b. In case, the shortfall is due to non-receipt of income or any other reason, the organisation has an option to exercise the option to apply the shortfall in the subsequent year or in the year of receipt. Such deemed application of income shall be considered when the institution furnishes the details electronically in Form 9A on or before the due date for furnishing of return of income of the relevant assessment year.

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that as per the present time line, the audit report has to be submitted within the 1 month prior to the due date, whereas Form 9A & 10 can be submitted within the due date. Hence the task of the auditor to certify the figure of accumulation/option becomes difficult in absence of Form 9A & 10 being submitted.

Proposed Amendments by Finance Bill 2023: It is proposed that Form 9A and Form 10 should be filed at least two months prior to the due date specified under Section 139(1) for furnishing the return of income for the previous year.

Various form	Due-date
Filing of ITR	31st October
Filing of Form 9A	31st August
Filing of Form 10	31st August

Issue arising out of it: This will have huge implication for the most of the NGOs as this amendment require accounts to be finalised on or before 31st August so as to determine the amount of shortfall in application and the relevant action to be taken.

PROVISIONAL REGISTRATION NO LONGER PERMISSIBLE ONCE ACTIVITIES ARE COMMENCED

Background and the context of amendment: Under the existing law, all organisations which are not yet registered under section 12AB can obtain Provisional Registration and after getting such registration they can consequently apply for normal registration within six months of the start of the activity. The present scheme of provisional registration remains same for both the situation i.e organisation who have commenced charitable activities and the organisations who are yet to commence charitable activities.

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that it has also been brought to the notice that trusts and institutions under both the regimes are facing the following difficulties:

- (a) Trusts or institutions formed or incorporated during the previous year are not able to get the exemption for that year in which they are formed or incorporated, since they need to apply one month before the previous year for which exemption is sought.
- (b) Besides trusts or institutions, where activities have already commenced, are required to apply for two registrations (provisional and regular) more or less simultaneously.

Proposed Amendments: It is proposed that under the newly inserted section 12A(1)(ac)(I), an organisation can only apply for provisional registration if its activity has not started. In other words, if the organisation has spent even a single rupee on charitable activities, it will have to apply for regular registration.

It is further proposed under the newly inserted section 12A(1)(ac)(ii) that all existing organisation whose activity has commenced should directly applied for regular registration which will be subject to scrutiny. Therefore, the organisations where activity has already been started, there is no need to apply twice.

Implication & issues arising out of it: The proposed provision of provisional registration is virtually meaningless as the organisations will have to apply for regular registration the moment it commences activity i.e., within six months. Further, getting provisional registration will not have any additional exemption benefit for open assessment of past years.

GIVING INCOMPLETE/FALSE INFORMATION CAN ATTRACT CANCELLATION OF REGISTRATION

Background and the context of

amendment: Cancellation proceedings can be initiated if the PCIT/CIT notices the occurrence of a specified violation, and the violation need not be noticed only during assessment. Explanation to Sec. 12AB(4) provides specified violation which results in cancellation. If the registration has been obtained on incomplete or false or incorrect information, the CIT has a power to cancel the registration after giving an opportunity of being heard. [Rule 17A(6)]

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023 : The memorandum explaining Finance Bill, 2023 states that it came to the notice that in some cases, form submitted for re-registration / approval are defective. Since the process of re-registration/ provisional registration is automated, the registration has already been granted and therefore, a need was felt to include the coverage of specified violation resulting into cancellation of registration.

Proposed Amendments: It is proposed that the specified violation under section 12AB(4) shall include the case where the application for approval or registration is incomplete or contains false or incorrect information.

Implication and Issues arising out of it: The provision of specific violation shall be invoked even if there are incomplete information. Cancellation proceeding for incomplete information seems to be a very harsh proviso. In our opinion, before initiating the cancellation proceeding under this specified violation, opportunity should be given to the concerned organisation to rectify the mistake in terms of the mandate as per Rule 17A(6).

EXIT TAX IF FAILS TO MAKE THE APPLICATION FOR RE-REGISTRATION / RENEWAL / PROVISIONAL TO REGULAR REGISTRATION

Background and the context of amendment: As per the new registration requirement:

- Every existing registered organisation under section 12A/12AA need to reregister.
- The re-registration shall be valid for 5 years' subject to further renewal.
- Once the provisional registration is granted, one needs to apply for normal registration.

Presently, there is no clarity in the law whether non-submission of application for re-registration/renewal/converting provisional registration to normal did not result in automatic cancellation and the organisations were allowed to continue without 12AB registration without any tax implication. The Finance Bill 2023 however, proposes to tax even if the organisations which surrenders or decide not to continue 12AB registration under section 115TD.

Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023: The memorandum explaining Finance Bill, 2023 states that instances were came to the notice that in a number of cases re-registration have not been applied and therefore, resulted into un-intentional exit route to the existing registration under section 12A/12AB without payment of Exit Tax under section 115TD.

Proposed Amendments: The Finance Bill 2023 proposes to amend Section 115TD to provide that the trust or institution (under the

first or second regime) shall be deemed to have been converted into any form not eligible for registration or approval in the previous year in which such period expires:

- (a) It fails to make an application for re-registration;
- (b) It fails to convert provisional registration to regular registration; or
- (c) It fails to get the renewal of registration within the specified period.

In such cases, the conversion date shall mean the last date for making an application for registration or approval expires.

Implication and Issues arising out of it: It is to be noted that in view of the Circular No.22/2022 dt. 25/11/2022, the last date of submission for re-registration by the existing organization registered under section 12A/12AA has been modified to 25/11/2022. Hence, due to this Circular all the existing organisations registered under section 12A/12AA, who fails to apply for registration shall be subject to Exit Tax under section 115TD and the date of default shall in such cases shall be 25/11/2022.

Similarly, if any organisation has not submitted the application for regularising its provisional registration, then such organisation shall also be subject to exit Tax on the expiry of last date of making such application.

It is also to be noted that the failure to make application shall be directly considered as a violation subject to section 115TD and there will be no requirement of a cancellation order from CIT to proceed under section 115TD. In other words, exit tax under section 115TD shall be imposed on the failure to submit the specified application before the last date.

FCRA - Confusions in Computation of Administrative Expenditure

Introduction

Section 8 of the FCRA, 2010 provides a cap of 20% on administrative expenses [reduced from 50% w.e.f 29th September 2020 vide FCR (Amendment) Act 2020] to be incurred from FC funds received during the year. The section also provides that the administrative expenses may exceed this limit of 20% with the prior approval of the Central Government.

The FCR (Amendment) Act 2020 (effective from 29th September 2020) has reduced the limit from 50% to 20% of the total foreign funds received in a particular year to defray administrative expenses. In other words, a FC registered organization cannot spend more than 20% of the FC received in that particular year on administrative expenses. There is a confusion with regard to the method of computing 20% of foreign funds for administrative expenses because an organisation may not receive any foreign contribution in a year but still have utilisation and vice versa. In this issue, the acceptable method of computing 20% administrative expenses has been discussed along with the basic provisions.

The Administrative Expenditure as per Rule 5 of FCRR, 2011 does not include Capital Expenditure. However, such capital expenditure should be towards advancement of charitable objectives. Otherwise, it shall be treated as either investment or applied for inadmissible purposes.

Rule 5 of FCRR 2011 provides specifically what shall be included under administrative expenses. It also provides certain exclusions. Under the current scheme of reporting under FCRA 2010, administrative expenditure is required to be reported to the FCRA authorities under clause 3(ii) of Form FC 4.

Statutory Provisions

FCRA, 2010 provides that administrative expenditure out of FC fund should not exceed 20% [reduced from 50% w.e.f 29th September 2020 vide FCR (Amendment) Act 2020] of FC fund received during a year. In this article, we shall try to understand the meaning of Administrative Expenditure for the purpose of FCRA 2010 and the provisions in relation thereto.

The text of Section 8 of FCR (Amendment) Act 2020: Regarding restriction to utilize foreign contribution for administrative purpose is as under:

"Restriction to utilize foreign contribution for administrative purpose

- (i) Every person, who is registered and granted a certificate or given prior permission under this Act and receives any foreign contribution, –
 - (a) shall utilise such contribution for the purposes for which the contribution has been received:

Provided that any foreign contribution or any income arising out of it shall not be used for speculative business; and

Provided further that the Central Government shall, by rules, specify the activities or business which shall be construed as speculative business for the purpose of this section.

- (b) shall not defray as far as possible such sum, not exceeding *twenty percent of such contribution, received in a financial year*, to meet administrative expenses:

Provided that administrative expenses exceeding twenty percent of such contribution may be defrayed with prior approval of the Central Government.

- (ii) The Central Government may prescribe the elements which shall be included in the administrative expenses and the manner in which the administrative expenses referred to in sub-section (1) shall be calculated."

It may be noted that the limit was reduced to 20% by the FCR (Amendment) Act 2020; earlier it was 50%. Section 8 of the FCRA, 2010 provides a cap on administrative expenditure upto 20% FC fund **received** during the year. The section also provides that the administrative expenditure may exceed this limit of 20% with the prior approval of Central Government. Rule 5 of FCRR 2011 provides specifically what shall be included under administrative expenditure. It also provides certain exclusions. The text of Rule 5 is as under:

"Administrative Expenses: -

- (i) salaries, wages, travel expenses or any remuneration realised by the Members of the Executive Committee or Governing Council of the person;
- (ii) all expenses towards hiring of personnel for management of the activities of the person and salaries, wages or any kind of remuneration paid, including cost of travel to such personnel;
- (iii) all expenses related to consumables like electricity and water charges, telephone charges, postal charges, repairs to premise(s) from where the organisation or association is functioning, stationery and printing charges, transport and travel charges by the Members of the Executive Committee or Governing Council and expenditure on office equipment;
- (iv) cost of accounting for and administering funds;
- (v) expenses towards running and maintenance of vehicles;
- (vi) cost of writing and filing reports;
- (vii) legal and professional charges; and
- (viii) rent of premises, repairs to premises and expenses on other utilities.

Provided that the expenditure incurred on salaries or remuneration of personnel engaged in training or for collection or analysis of field data of an association primarily engaged in research or training shall not be counted towards administrative expenses.

Provided further that the expenses incurred directly in furtherance of the stated objectives of the welfare oriented organisation shall be excluded from the administrative expenses such as salaries to doctors of hospital, salaries to teachers of school, etc."

How the 20% Limit Should be Computed in the Light of the Word "Received" Used in the Section

As discussed above, section 8(1) of the FCRA, 2010 states that the administrative expenditure should not exceed 20% of the foreign contribution received during financial year. However, the literal interpretation of the above provision will lead to absurdity and render the section otiose and inoperative in various circumstances. For example, an organisation receives Rs.5 lakhs foreign contribution in the financial year 2021-22, but does not utilise the amount in the same financial year. In the subsequent financial year 2022-23, it does not receive any foreign contribution, but utilises Rs.5 lakhs for charitable purposes. In this case, on a literal interpretation of section 8(1) of the FCRA, 2010, the organisation will not be entitled to any administrative expenditure in the FY 2022-23, which could not have been the intent of the statute.

On the contrary, if the organisation follows the principle of confining the amount of administrative expenses to 20% of the amount utilised, then it would be complying with the 20% limit, both with regard to receipt as well as utilisation. For example, an organisation receives Rs.5 lakhs foreign contribution the financial year 2021-22 but equally utilises the amount in the next 5 financial years including the financial year 2021-22. In this case, the

organisation can claim Rs.20,000/- as administrative expenditure in each of the 5 financial years of utilisation. Further, the total administrative expenditure at the end of the 5-years would not be more than 20% of the amount of contribution received in financial year 2021-22.

In our opinion, the 20% limit of administrative expenditure should be calculated based on the amount utilised during the year. This interpretation is based on the various judgements of Supreme Court and High Courts, wherein it has been ruled that the statute should be interpreted in a sensible manner, if there is a drafting defect or, if the literal interpretation would render the provisions of the statute otiose or inoperative. The Supreme Court of India in the case of *Shamarao V. Parulekar vs The District Magistrate, Thana, ...* on 26 May, 1952 AIR 324, 1952 SCR 683, held that if the grammatical or literal meaning of a statute leads to absurdity and inconsistency then the interpretation which through common sense reflects the intent of the statute should be adopted.

The relevant observation of the Apex Court is as under:

"It is the duty of Courts to give effect to the meaning of an Act, when the meaning can be fairly gathered from the words used, that is to say, if one construction will lead to an absurdity while another will give effect to what common sense would show was obviously intended the construction which would defeat the ends of the Act, must be rejected even if the same words used in the same section, and even the same sentence,

have to be construed differently. Indeed, the law goes so far as to require the Courts, sometimes, even to modify the grammatical and ordinary sense of the words if by doing so absurdity and inconsistency can be avoided."

The Andhra High Court in the case of N. Sarada Mani vs G. Alexander and Anr. on 21 October, 1997, AIR 1998 AP 157, 1997 (6) ALT 270, held that if the literal or grammatical interpretation of the statute makes it otiose or inoperative, then a liberal construction should be adopted in order to make the provision effective and operative. The court further object that if there is a defect in drafting of the statute, then the possible intention of the legislature should be adopted. The relevant extract from the order is as under:

"7. We are aware that it is well settled principle of law that while resorting to interpreting some of the provisions of a statute, Courts should be loath and adopt a construction which tends to make any part of the statute otiose. Courts should always strive for arriving at a balanced view by adopting the rule of liberal construction so as to ensure its full meaning to all parts of the provision and make as far as possible the whole of it effective and operative."

8. In Pickstone v. Freeman PLC, (1988) 2 All ER 803, it is observed: "Application of mischief rule or purposive construction may also enable reading of words by implication when there is in doubt about the purpose which the Parliament intended to achieve. But before any words are read to repair an omission in the Act, it should be possible to state with certainty that these words should have been inserted by the Draftsman and approved by Parliament had their attention been drawn

to the omission before the Act passed into law."

In R.v.R., (1991) 4 All ER 481, it is observed that "the literal reading of words would have frustrated substantially the purpose of enactment and would have led to the absurdity of supposing that the intention of legislation was to subject to licensing control, only those establishments conducted in the least offensive way and to leave those which pander more outrageously from any control or legal restraint."

Whether Administrative Expenditure includes Capital Expenditure

The Administrative Expenses as Rule-5 of FCRR, 2011 does not include Capital Expenditure.

It may be noted that Form FC-4 bifurcates total FC Utilization as under:

- (a) Details of utilization of Foreign Contribution:
 - i.) Total utilization for projects as per aims and objectives of the association (Rs.)
 - ii.) Total Administrative expenses as provided in rule 5 of the Foreign Contribution (Regulations) Rules, 2011(Rs.)
- (b) Total purchase of fresh assets (Rs.)
- (c) FC transferred to other associations.

The above reporting requirements also consider Capital expenditure and Administrative Expenditure separately, for the purposes of FCRA, 2010.

However, such capital expenditure should be towards advancement of charitable objectives otherwise, shall be treated as either investments or applied for inadmissible purposes.

Is Separate Accounting Necessary for Administrative Expenditure as per FCRA

The requirement of separate Books of Account is for FC fund received and utilised. Separate ledger or books for administrative expenditure are not required to be maintained. However, the organisation should be in a position to clearly segregate the expenditure, which is administrative in nature from the books of account maintained by them.

Is Administrative Expenditure Required to be Reported to FCRA Authorities

Under the current law, the administrative expenditure is required to be reported to the FCRA authorities under clause 3(ii) of Form FC-4. It is a statutory compliance which the organisation has to follow.

Consequences of Incurring Administrative Expenditure in Excess of Specified Limit of 20%

Administrative expenditure in excess of 20% without prior approval of Central Government shall constitute non-compliance under FCRA, 2010. In such cases, the person may have to go for compounding of this non-compliance under section 41 of FCRA 2010. As per the Notification dated 05.06.2018 providing for compounding fees, it is provided that for spending more than 20% of the Administrative Expenditure, the compounding fees shall be Rs.1 lacs or 5% of excess expenditure on Administration whichever is higher.

It may be noted that the penalty in any case cannot exceed the amount of foreign contribution involved in non-compliance. For example, if the administrative expenditure exceeds the 20% limit by Rs.10,000/-, then the total penalty will be only Rs.10,000/- and not Rs.1,00,000/-.

Can the Violation Pertaining to Administrative Expenses Be Compounded Every Year?

It may be noted that under section 41(2), an offence once compounded cannot be compounded again within a period of 3 years i.e. second or subsequent offences cannot be compounded within a block of 3 years. In other words, a violation pertaining to administrative expenditure cannot be compounded more than once in block of three years. The Act does not specifically provide for the penalty for second or third offence pertaining to administrative expenses, but it will be treated as a violation under the Act which may lead to non-renewal or cancellation of the certificate of registration.

Nothing in sub-section 41(1) shall apply to an offence committed by an individual or association or its officer or other employee within a period of three years from the date on which a similar offence committed by it or him was compounded under this section.

"The amount of penalty computed under column (3) of the Table in respect of any offence or offences referred to in column (2) thereof shall not be more than the value of the foreign contribution involved."

Can Fund Raising Expenses Be Claimed as Administrative Expenses

It has been noticed that many organisations

treat fund raising expenses as a part of administrative expenses. However, in our opinion, fund raising expenses cannot be treated as either administrative expenses or programme expenses for the following reasons:

- Fund raising expenses do not form a part of the expenses incurred during the implementation of a programme. For example, accounting or audit expense are required during the implementation even though they are administrative in nature.
- If the fund is raised in India, then it will be legally incorrect to use FC funds for

raising such funds. In some cases, the donor provides grant for fund raising in India; in this context, it may be noted that "fund raising" itself cannot be treated as a definite purpose under section 11 of FCRA 2010. In other words, a foreign donor has to give grant for a definite purpose permissible under FCRA.

- Fund raising expenses are normally charged against the fund raised and the net amount is treated as income, therefore, the question of treating them as application towards objectives does not arise.

Charitable Activity & Business - Supreme Court Judgement On General Public Utility Institutions

Introduction

The Supreme Court of India in the case of ACIT(E) vs. Ahmedabad Urban Development Authority Civil Appeal No. 21762 of 2017 dated 19th October 2022, has given a landmark judgement which will have far reaching impact on General Public Utility (herein after referred as GPU) institutions subject to exemption under section 11. This ruling will also have impact on other charitable & religious institutions as far as incidental business activities are concerned.

The major conclusions from the judgement with regard to the definition of 'charitable purpose' under section 2(15) w.e.f 01.04.2009 with later amendments thereof are summarized as under:

- a. It is clarified that an assessee advancing general public utility cannot engage itself in any trade, commerce or business, or provide service in relation thereto for any consideration ("cess, or fee, or any other consideration");
- b. However, in the course of achieving the object of general public utility, the concerned trust, society, or other such organization, can carry on trade, commerce or business or provide services in relation thereto for consideration, provided that (i) the activities of trade, commerce or business are connected ("actual carrying out..." inserted w.e.f. 01.04.2016) to the achievement of its objects of GPU; and

(ii) the receipt from such business or commercial activity or service in relation thereto, does not exceed 20% of total receipts of the previous year, w.e.f. 01.04.2016);

- c. Generally, the charging of any amount towards consideration for such an activity (advancing general public utility), which is on cost-basis or nominally above cost, cannot be considered to be "trade, commerce, or business" or any services in relation thereto. It is only when the charges are markedly or significantly above the cost incurred by the assessee in question, that they would fall within the ambit of "cess, or fee, or any other consideration" towards "trade, commerce or business". In this regard, the Court has clarified through illustrations, what kind of services or goods provided on cost or nominal basis would normally be excluded from the mischief of trade, commerce, or business, in the body of the judgment;
- d. Section 11(4A) must be interpreted harmoniously with Section 2(15). Carrying out activity in the nature of trade, commerce or business, or service in relation to such activities, should be conducted in the course of achieving the GPU object, and the income, profit or surplus or gains must, therefore, be incidental. The requirement in Section 11(4A) of maintaining separate books of account is also in line with the necessity of demonstrating that the limit

prescribed in the proviso to Section 2(15), has not been breached. Similarly, the insertion of Section 13(8), seventeenth proviso to Section 10(23C) and third proviso to Section 143(3) (all w.r.e.f. 01.04.2009), reaffirm this interpretation and bring uniformity across the statutory provisions.

Can A "GPU" Institution Have Profit Making Activity

The Supreme Court in this ruling has held that a GPU institution should engage only in charitable activity, it cannot engage in any other business or profit making activity unless such activity is required as a part of actual advancement of the objectives. The relevant para from page 141 of the judgement is reproduced as under:

"A.1. It is clarified that an assessee advancing general public utility cannot engage itself in any trade, commerce or business, or provide service in relation thereto for any consideration ('cess, or fee, or any other consideration');

A.2. However, in the course of achieving the object of general public utility, the concerned trust, society, or other such organization can carry on trade, commerce or business or provide services in relation thereto for consideration, provided that (i) the activities of trade, commerce or business are connected ('actual carrying out...' inserted w.e.f. 01.04.2016) to the achievement of its objects of GPU; and (ii) the receipt from such business or commercial activity or service in relation thereto, does not exceed the quantified limit, as amended over the years (Rs.10 lakhs w.e.f. 01.04.2009; then Rs.25 lakhs w.e.f. 01.04.2012; and now 20% of total receipts of the previous year, w.e.f. 01.04.2016)."

In the light of above, if the GPU institution seems to be working with a profit motive i.e. the fees collected from the beneficiaries is substantially more than the cost of services then such organisation will not be eligible for exemptions. The effect of the ruling will apply to all charitable organisations who charge their beneficiaries.

The ruling further states that there is no bar in having surplus provided such surplus is generated in the course of charitable activities. In other words, a GPU institution can generate profit from its beneficiaries, provided it is reasonable and there is no dominant profit motive. It is pertinent to quote another Supreme Court ruling where the reasonableness of permissible surplus was decided. The Hon'ble Supreme Court in the case of Islamic Academy of Education v. State of Karnataka on 14 August, 2003, WP (Civil) 350 of 1993, held that an educational institution can have reasonable surplus upto 6% to 15% every year without affecting its charitable character.

The Meaning of the Word 'Incidental' to Determine Permissible Business Activity

The Supreme Court has taken a very narrow view of the term incidental in context of incidental business activities. In the past, the Supreme Court had taken a very liberal interpretation of the term 'incidental'. For instance, Supreme Court in the case of Asstt. CIT v. Thanthi Trust [2001] 115 Taxman 126, had held that if the income generated from a business of publishing newspaper is totally used for charitable purposes, then such business should be considered as incidental.

The Apex Court has categorically held that a business activity, in order to be incidental, must be conducted in the course of achieving the actual object. Further, the court has also held that business activity shall be determined

under section 11(4A). In other words, there is no scope of having any commercial activity under proviso to section 2(15). The relevant para from page 142 is reproduced as under:

"A.4. Section 11(4A) must be interpreted harmoniously with Section 2(15), with which there is no conflict. Carrying out activity in the nature of trade, commerce or business, or service in relation to such activities, should be conducted in the course of achieving the GPU object, and the income, profit or surplus or gains must, therefore, be incidental. The requirement in Section 11(4A) of maintaining separate books of account is also in line with the necessity of demonstrating that the quantitative limit prescribed in the proviso to Section 2(15), has not been breached. Similarly, the insertion of Section 13(8), seventeenth proviso to Section 10(23C) and third proviso to Section 143(3) (all w.e.f. 01.04.2009), reaffirm this interpretation and bring uniformity across the statutory provisions."

This Supreme Court ruling will have a very far reaching implication on the incidental and other business activities of GPU as well as other charitable or religious institutions.

Now, an incidental business activity should have a direct relationship with the advancement of the main objective. For example, selling books to students can be incidental business activity but the same activity for non-student will not be treated as an incidental business activity.

Charging Fee Significantly Above Cost Will Be Treated as Business

The Supreme Court held that any fee or consideration charged should be nominally above cost. In other words, in order to be

treated as "trade, commerce or business", the amount charged should be significantly above cost. The relevant para from page 141 is reproduced as under:

"A.3. Generally, the charging of any amount towards consideration for such an activity (advancing general public utility), which is on cost-basis or nominally above cost, cannot be considered to be "trade, commerce, or business" or any services in relation thereto. It is only when the charges are markedly or significantly above the cost incurred by the assessee in question, that they would fall within the mischief of "cess, or fee, or any other consideration" towards "trade, commerce or business". In this regard, the Court has clarified through illustrations what kind of services or goods provided on cost or nominal basis would normally be excluded from the mischief of trade, commerce, or business, in the body of the judgment."

Will the Judgement Affect Incidental Business Activities of All Institutions Other Than Engaged in GPU

The judgement will have a far reaching effect on the incidental and other business activities of all category of charitable or religious institutions. This judgement is not confined only to GPU as far as business activities are concerned. It may be noted that the Supreme Court has analysed section 11(4A) which applies to the incidental business activities of all categories of charitable or religious institutions. Therefore, in our opinion, this judgement will severely impact all charitable and religious institutions having incidental business activities. All charitable institutions cannot have any business or commercial activity which is not directly related with the advancement of their objectives. Therefore, all kinds of consulting/commercial contracts,

export of service or services to non-beneficiaries will no longer be permissible.

Authorities, Corporations or Bodies Established by Statute

The Supreme Court has excluded authorities and statutory corporations such as city development authority or housing development authority, etc. The Apex Court has held that any charges or fees collected by such institutions shall not be treated as commercial activity provided the charges are not significantly above cost. The relevant paras from page 142 are reproduced as under:

"B.1 The amounts or any money whatsoever charged by a statutory corporation, board or any other body set up by the state government or central governments, for achieving what are essentially 'public functions/ services' (such as housing, industrial development, supply of water, sewage management, supply of food grain, development and town planning, etc.) may resemble trade, commercial, or business activities. However, since their objects are essential for advancement of public purposes/functions (and are accordingly restrained by way of statutory provisions), such receipts are prima facie to be excluded from the mischief of business or commercial receipts. This is in line with the larger bench judgments of this court in Ramtanu Cooperative Housing Society and NDMC (supra).

B.2 However, at the same time, in every case, the assessing authorities would have to apply their minds and scrutinize the records, to determine if, and to what extent, the consideration or amounts charged are significantly higher than the cost and a nominal mark-up. If such is the case, then the receipts would indicate that the

activities are in fact in the nature of "trade, commerce or business" and as a result, would have to comply with the quantified limit (as amended from time to time) in the proviso to Section 2(15) of the IT Act.

B.3 In clause (b) of Section 10(46) of the IT Act, "commercial" has the same meaning as "trade, commerce, business" in Section 2(15) of the IT Act. Therefore, sums charged by such notified body, authority, Board, Trust or Commission (by whatever name called) will require similar consideration - i.e., whether it is at cost with a nominal mark-up or significantly higher, to determine if it falls within the mischief of "commercial activity". However, in the case of such notified bodies, there is no quantified limit in Section 10(46). Therefore, the Central Government would have to decide on a case-by-case basis whether and to what extent, exemption can be awarded to bodies that are notified under Section 10(46).

B.4 For the period 01.04.2003 to 01.04.2011, a statutory corporation could claim the benefit of Section 2(15) having regard to the judgment of this Court in the Gujarat Maritime Board case (supra). Likewise, the denial of benefit under Section 10(46) after 01.04.2011 does not preclude a statutory corporation, board, or whatever such body may be called, from claiming that it is set up for a charitable purpose and seeking exemption under Section 10(23C) or other provisions of the Act."

Statutory Regulators

The Supreme Court has also excluded statutory regulators such as Institute of Chartered Accountants of India, Medical Council of India, etc. The Apex Court has held that any charges or fees collected by such

institutions shall not be treated as commercial activity provided the charges are not significantly above cost. The relevant paras from page 143 are reproduced as under:

"C.1. The income and receipts of statutory regulatory bodies which are for instance, tasked with exclusive duties of prescribing curriculum, disciplining professionals and prescribing standards of professional conduct, are prima facie not business or commercial receipts. However, this is subject to the caveat that if the assessing authorities discern that certain kinds of activities carried out by such regulatory body involved charging of fees that are significantly higher than the cost incurred (with a nominal mark-up) or providing other facilities or services such as admission forms, coaching classes, registration processing fees, etc. at markedly higher prices, those would constitute commercial or business receipts. In that event, the overall quantitative limit prescribed in the proviso to Section 2(15) (as amended from time to time) has to be complied with, if the regulatory body is to be considered as one with 'charitable purpose' eligible for exemption under the IT Act.

C.2. Like statutory authorities which regulate professions, statutory bodies which certify products (such as seeds) based on standards for qualification, etc. will also be treated similarly."

Trade Promotion Bodies

The Supreme Court held that Trade Promotion Bodies such as Apparel Export Promotion Council (AEPC) etc. can be said to be involved in advancement of objects of GPU Institutions, even if they collect fees or

charge their members and beneficiaries. The Apex Court held that any charges or fees collected by such institutions shall not be treated as commercial activity provided the charges are not significantly above cost. The relevant paras from page 144 are reproduced as under:

"Bodies involved in trade promotion (such as AEPC), or set up with the objects of purely advocating for, coordinating and assisting trading organisations, can be said to be involved in advancement of objects of general public utility. However, if such organisations provide additional services such as courses meant to skill personnel, providing private rental spaces in fairs or trade shows, consulting services, etc., then income or receipts from such activities, would be business or commercial in nature. In that event, the claim for tax exemption would have to be again subjected to the rigors of the proviso to Section 2(15) of the IT Act."

Non-Statutory Bodies

The Supreme Court held that Non-Statutory Body such as Education & Research in Computer Networking (ERNET), National Internet Exchange of India (NIXI) etc. can be said to be involved in advancement of objects of GPU Institutions, even if they collect fees or charge their members and beneficiaries. The Apex Court has held that any charges or fees collected by such institutions shall not be treated as commercial activity provided the charges are not significantly above cost. The relevant paras from page 144 are reproduced as under:

"E.1 In the present batch of cases, non-statutory bodies performing public functions, such as ERNET and NIXI are engaged in important public purposes.

The materials on record show that fees or consideration charged by them for the purposes provided are nominal. In the circumstances, it is held that the said two assesseees are driven by charitable purposes. However, the claims of such non-statutory organisations performing public functions, will have to be ascertained on a yearly basis, and the tax authorities must discern from the records, whether the fees charged are nominally above the cost, or have been increased to much higher levels.

E.2. It is held that though GS1 India is in fact, involved in advancement of general public utility, its services are for the benefit of trade and business, from which they receive significantly high receipts. In the circumstances, its claim for exemption cannot succeed having regard to amended Section 2(15). However, the Court does not rule out any future claim made and being independently assessed, if GS1 is able to satisfy that what it provides to its customers is charged on cost-basis with at the most, a nominal mark up."

Sports Associations

The Supreme Court has reserved its order with regard to Sports Associations and has directed the Assessing Officer to adjudicate the matter afresh.

Private Trusts

The Supreme Court has also provided interpretation for private trusts (privately controlled trust for public charitable purposes). The judgement of the case: *The Trustees of Tribune Press, Lahore v. CIT, Punjab* (1939) 7 ITR 415, with regard to the advertisement and other income of newspapers was discussed. The Court further passed verdict on the Punjab-Haryana High

Court judgement in the case: *Tribune Trust Chandigarh vs Commissioner of Income Tax, ITA No. 62 of 2015* passed on 23 December, 2016. It held that an organisation engaged in publication of newspaper will be treated as a GPU institution however, its income from advertisements etc. cannot exceed the 20% limit given under section 2(15). The relevant para from the judgement with emphasis is reproduced as under:

"245. The publication of advertisements for consideration, in the opinion of the court, by the newspaper, cannot but be termed as an activity in the nature of carrying on business, trade or commerce for a fee or consideration. That the newspaper published by the trust ("the Tribune") in this case is funded mainly through advertisement is no basis for holding that publishing such advertisements by the Trust does not constitute business. The object of the trust to involve or engage in publication of newspapers. Publishing advertisements is obviously to garner receipts which are in the nature of profit. Now, by virtue of the amended definition of Section 2(15), GPU charities can engage themselves in business or commercial activity or profit, only if the receipts from such activities do not exceed the quantitative limit of the overall receipts earned in a given year. While the assessee's contention that publication of advertisement is intrinsically linked with newspaper activity (thereby fulfilling sub clause (i) of the proviso to Section 2(15), i.e. an activity in the course of actual carrying on of the activity towards advancement of the object) is acceptable, nevertheless, the condition imposed by sub-clause (ii) of the proviso to Section 2(15) has also to be fulfilled. In the present case, that percentage had been exceeded, as evident from the record.

246. In the light of the foregoing discussion, this court is of the opinion that the impugned judgment and order of the Punjab and Haryana High Court cannot be sustained, to the extent it holds that the Tribune trust is not a GPU charity. However, having regard to the factual analysis, the judgment needs no interference."

The impact of this judgement will again have far reaching effect on all privately controlled public trusts, which have incidental business or commercial activity. All such trusts will be treated as GPU charities but their income from such advertisement or other incidental business cannot exceed the 20% limit provided under section 2(15). The final judgement of the court in this regard is reproduced as under:

"So far as the appeal by assessee-Tribune Trust is concerned, it has been held that despite advancing general public utility, the Trust cannot benefit from exemption offered to entities covered by Section 2(15) as the records reveal that income received from advertisements, constituted business or commercial receipts. Consequently, the limit prescribed in the proviso to Section 2(15) has to be adhered to for the Trust's claim of being as a charity eligible for exemption, to succeed. Therefore, despite differing reasoning, this court has held that the impugned judgment of the High Court does not call for interference."

Concluding Remarks

In the light of the above, a charitable or religious institution can have business activities subject to the following conditions:

- (i) The business activity should be related to the advancement of the objects of GPU

and therefore, all unrelated business activities shall no longer be permissible, even if the entire income is used for charitable purposes.

- (ii) The business activity, which is related to the advancement of the objects, should be less than 20% of the total receipts of the organisation. Such business activity should be separately accounted under section 11(4A). In case of other charitable institution, the 20% limit shall not apply, but if the business activity is considerably above 20% of the total receipt of the organisation, then the organisation itself may be deemed to be working with a dominant profit motive and its genuineness as a charitable organisation itself be under risk.
- (iii) When fees or any other charge is collected from the beneficiaries then such charge should be reasonable and not significantly higher than the cost. If the charge is significantly higher than the cost, then such activity will be treated as incidental business activity under section 11(4A). In case of GPU institutions, the quantum of such activity cannot exceed 20% of total receipt. In case of other organisations, though they can have more than 20% of such activity, if such incidental business activity is substantially more than 20%, then their genuineness as a charitable organisation itself be under question mark.
- (iv) All charitable institutions cannot have any business or commercial activity which is not directly related with the advancement of their objectives. Therefore, all kinds of consulting/commercial contracts, export of service or services to non-beneficiaries will no longer be permissible.

Tax Audit of NPOs - Audit Report Under Form 10B and Form 10BB

Introduction

NPOs exempt under Sections 11 and 12 of the Income Tax Act are required to meet certain conditions, one of which is the auditing of their accounts under Section 12A(1)(b). Similarly, the tenth proviso to Section 10(23C) requires institutions approved under that clause to have their accounts audited. Trust or institutions, with income exceeding the maximum amount not chargeable to tax are required to get their accounts audited.

Recently, there have been radical changes in the reporting format of the auditor's report under Form 10B and 10BB. The amended forms are comprehensive with many changes and certifications which were not required earlier.

CBDT has notified new audit reports in Form 10B and 10BB to be furnished by charitable or religious trusts and other institutions vide Notification No. 7/2023, dated 21-02-2023. As per the amended Rules, common forms are being prescribed for the organisations registered under section 12AB and the organisations approved under section 10(23C), and the distinction for use of Form 10B and 10BB is made on the basis of specified situations, mainly on the basis of total income of the trust/institution exceeding INR 5 crore without giving effect of Section 11, 12 & 10(23C), or receiving foreign contribution or, on the basis of amount applied outside India.

In other words, Form 10B shall be used in the following circumstances:

- (i) Organisations having total income of INR 5 crore or more,
- (ii) Organisations that have received foreign contribution,
- (iii) Organisations that have applied income outside the country.

For all other organisations, Form 10BB shall be used.

Requirement of Audit

It is mandatory for a trust to get its books of accounts audited to avail the exemption under Section 11 and Section 12. The relevant extract of section 12A(1)(b) is as under:

"(b) where the total income of the trust or institution as 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 in any previous year,-

- (i)
- (ii) *the accounts of the trust or institution for that year have been audited by an accountant defined in the Explanation below sub-section (2) of section 288 before the specified date referred to in section 44AB and the person in receipt of the income furnishes by that date,*

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;"

Therefore, if the income of the trust/institution without giving effect to the provisions of sections 11 and 12 exceeds the maximum amount which is not chargeable to income-tax, it is mandatory for a trust/institution to get their accounts audited before the specified date and also furnish the audit report by that date.

Pre-Amended Rule 16CC and Rule 17B

Rule 16CC and Rule 17B provides for the format of audit report to be used by the charitable institutions registered under section 12AB or approved under section 10(23C).

Prior to the Notification No. 7/2023, dated 21-02-2023, Rule 16CC provided Form 10BB for the organisations approved under section 10(23C) and Rule 17B, provided Form 10B for the organisations registered under section 12AB.

Hence, two separate forms were used for two different types of organisations. Form 10B was used for organisations registered under section 12AB, and Form 10BB was used for organisations approved under section 10(23C).

Amended Rule 16CC & Rule 17B w.e.f. 01-04-2023

Rule 16CC and Rule 17B of the Income-Tax Rules, 1962 have been substituted w.e.f. 01-04-2023 vide Income-tax amendment (3rd Amendment) Rules, 2023.

CBDT has notified new audit reports in Form 10B and 10BB to be furnished by charitable or religious trusts and other institutions vide Notification No. 7/2023, dated 21-02-2023.

As per the amended Rules, common forms have been prescribed for the organisations registered under section 12AB and the organisations approved under section 10(23C). The distinction for use of Form 10B and 10BB is made on the basis of specified circumstances:

- Form 10B is required to be used if the total income of the trust/institution exceeds INR 5 crores without giving the effect of Section 11, 12 & 10(23C), otherwise Form 10BB will be used.
- Form 10B is required to be used if the organisations have received foreign contribution even if the income is below INR 5 crores.
- Form 10B is required to be used if the income is applied outside India, even if the income is below INR 5 crores.

Amendments at a Glance

In the Income - Tax Rules, 1962, hereinafter referred to as the Principal Rules, Rule 16CC has been substituted as follows:

"Rule 16CC. Form of report of audit prescribed under tenth proviso to section 10(23C).- *The report of audit of the accounts of a fund or institution or trust or any university or other educational institution or any hospital or other medical institution which is required to be furnished under clause (b) of the tenth proviso to clause (23C) of section 10 shall be in-*

(a) Form No. 10B where;

(i) the total income of such fund or institution or trust or university or other educational institution or hospital or other medical institution, without giving effect to the provisions of the sub-clauses (iv), (v), (vi) and (via) of the said clause, exceeds rupees five crores during the previous year; or

(ii) such fund or institution or trust or university or other educational institution or hospital or other medical institution has received any foreign contribution during the previous year; or

(iii) such fund or institution or trust or university or other educational institution or hospital or other medical institution has applied any part of its income outside India during the previous year;

(b) Form No. 10BB in other cases.

Explanation.- For the purposes of sub-clause (II) of clause (a), the expression "foreign contribution" shall have the same meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Foreign Contribution (Regulation) Act, 2010 (42 of 2010)."

In the principal Rules, Rule 17B has been substituted as follows:

"17B. Audit report in the case of charitable or religious trusts, etc. - The report of audit of the accounts of a trust or institution which is required to be furnished under sub-clause (ii) of clause (b) of subsection (1) of section 12A, shall be in-

(a) Form No. 10B where-

(i) the total income of such trust or institution, without giving effect to the provisions of sections 11 and 12 of the Act, exceeds rupees five crores during the previous year; or

(ii) such trust or institution has received any foreign contribution during the previous year; or

(iii) such trust or institution has applied any part of its income outside India during the previous year;

(b) Form No. 10BB in other cases.

Explanation.- For the purposes of sub-clause (II) of clause (a), the expression 'foreign contribution' shall have the same meaning assigned to it in clause (b) of sub-section (1) of section 2 of the Foreign Contribution (Regulation) Act, 2010 (42 of 2010)."

Summary of Amended Rules

Who is required to file Form 10B ?

The trusts or institutions registered under Section 12AB or approved under Section 10(23C) who satisfy any of the following conditions must file an audit report in Form 10B:

(a) If the total income of the trust or institution, without giving effect to the provisions of sections 11 and 12 or Section 10(23C) (iv), (v), (vi), (via) of the Act, exceeds rupees five crores during the previous year; or

- (b) If such trust or institution has received any foreign contribution during the previous year; or
- (c) If such trust or institution has applied any part of its income outside India during the previous year.

Who is required to file an audit report in Form 10BB?

The trusts or institutions registered under Section 12AB or approved under Section 10(23C) not falling into any of the above mentioned criteria must file an audit report in Form 10BB. Hence, reporting in Form No. 10BB must be used if all of the following situations are satisfied:

- (a) If the total income of the trust or institution, without giving effect to the provisions of sections 11 and 12 or Section 10(23C) (iv), (v), (vi), (vii) of the Act is up to rupees five crores; &
- (b) If such trust or institution has not received any foreign contribution during the previous year; &
- (c) If such trust or institution has not applied any part of its income outside India during the previous year.

Points to be noted:

- (a) If the organisation receives even a single rupee as foreign contribution, then such organisation is required to choose Form 10B, despite the fact that the total income of the trust/institution is much less than the specified limit of INR 5 crores. It may further be noted that Form 10B shall also apply in cases where the

organization has earned bank interest from FC funds.

- (b) It may also be noted that in case an organisation is registered under FCRA but has not received any foreign contribution, including bank interest from the FC bank account and it has not applied any income outside India, then such organisation shall have to choose Form 10B or Form 10BB, depending upon its total income without giving effect of Section 11 & 12.

Form 10B and Form 10BB

The audit report in Form 10B/10BB consists of two parts:

- (a) Audit Report
- (b) Annexure

Every year, a trust is required to prepare financial statements such as the balance sheet and income and expenditure statement based on its books of accounts. An audit report is then prepared to assist the Income-tax department in verifying whether the assessee has complied with the provisions of sections 11 to 13 and Section 10(23C) of the Act.

The auditor is required to provide an opinion in the audit report stating that the balance sheet and profit and loss account/income and expenditure account of the entity for the year ended are in agreement with the books of account maintained by the entity. Additionally, the auditor must provide an opinion stating that proper books of account have been maintained at the registered office of the entity and that the particulars given in the annexure are true and correct, subject to any observations or qualifications.

Comparison of the Amended Format of the Audit Report with the Previous Format

On comparing the newly amended format of the audit report with the previous one, we have identified the following differences:

- (i) Financial Statement to be examined,
- (ii) Information on place of maintaining of books of account,
- (iii) Opinion by the Auditor on the Financial Statement,
- (iv) Opinion by the Auditor on annexure forming part of Form 10B/10BB.

Financial Statement to be examined

Pre-Amended:

The auditor was required to examine the Balance Sheet and the Profit & Loss Account.

Amended:

According to the amended format, the auditor is required to provide certification for the Balance Sheet, Income & Expenditure Account or Profit & Loss Account.

Analysis:

The inclusion of the term "Income & Expenditure Account" is appropriate in the context of NPOs. However, allowing the option to include either Income & Expenditure Account or Profit & Loss Account, while continuing to refer the latter as a financial statement, requires further clarity. In most cases, it is deemed appropriate that auditors should include the Balance Sheet and

Income & Expenditure Account.

Further, the Receipt and Payment account has not been referred to as one of the financial statements, even though most of the income and application are considered on a cash basis.

Information on place of maintaining of books of account

Pre-amended:

The auditor was required to certify that, in their opinion, proper books of account have been maintained by both the head office and branches, and that they have received all necessary books of account and returns for the audit. However, there was no requirement to include information about the location where the books of account are maintained.

Amended:

The amended format requires Auditors to include the following:

*"In * my/our opinion, proper books of account have been maintained at the registered office of the above named fund or trust or institution or university or other educational institution or hospital or other medical institution at the address mentioned at row 11 of the Annexure"*

Analysis:

It is important to note that Rule 17AA mandates the maintenance of books of account and requires that they are to be kept at the registered office of the organization. However, if the books of account are maintained at a location other than the registered office, the Assessing Officer must be notified within a specified time frame. This modification in the audit report format is in

line with the new requirement of Rule 17A regarding the maintenance of books of account.

Opinion by the Auditor on the Financial Statement:

Pre-amended:

The auditor was required to report that:

- (i) in the case of the balance sheet, of the state of affairs of the above named 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

Amended:

As per the modified format the auditor is required to report that:

- (i) in the case of the balance sheet, of the state of affairs of the above named * fund or trust or institution or university or other educational institution or hospital or other medical institution as on; and
- (ii) in the case of the Income and Expenditure account or Profit and Loss account, of the income and application/ profit or loss of its accounting year ending on

Analysis:

The key distinguishing feature in the opinion part is the use of the words "in the case of Income and Expenditure Account, of the **income and application of its accounting year ending on**". This is the most

appropriate inclusion in the opinion part because as per the present scheme of taxation, the amount of "application" is required to be computed which is a broader term than "expenditure". However, the financial statements are still referred to as "Income & Expenditure Account" not "Income & Application Account".

However, as the new format requires the opinion on the amount of application, then the Income & Expenditure Account must include even the Capital expenses and the amount applied out of the loan, etc. so that the amount of application to be computed under Income Tax Act is duly reflected in the Income & Expenditure Account.

Opinion by the Auditor on annexure forming part of Form 10B/10BB:

Pre-amended:

There was no requirement for making separate certification on the Annexure forming part of Form 10B, though it was mentioned in the audit report "the prescribed particulars are annexed hereto_".

Amended:

The amended format requires opinion on -

*"In *my/our opinion and to the best of *my/our information and according to explanations given to *me/ us, the particulars given in the Annexure are true and correct subject to following observations or qualifications, if any-*

(a).....

(b).....

(c)....."

Analysis:

This new requirement removes any ambiguity regarding whether the auditor should audit the annexure forming part of the audit report. Now, the auditor is required to audit the annexure and provide a certification whether the annexure is true and correct.

Comprehensive Changes in Annexure to Audit Report in Form 10B & 10BB

The Annexure to Form 10B & 10BB is a statement of particulars - that forms part of the audit report. The auditor is required to give an opinion on whether the particulars given in the Annexure are true and correct subject to the observations or qualifications, if any.

There are comprehensive changes in the contents and requirements of the annexure forming part of Form 10B and Form 10BB. The annexure forming part of Form 10BB consist of 15 sections and 6 schedules, whereas the annexure forming part of Form 10B consist of 26 sections and 19 schedules.

Overview of Annexure to Form 10BB

The Form 10BB consists of fifteen sections, each has either one of more rows requiring information to be furnished against that particular section. In some case, schedules are also required to be filled in. A snapshot of information asked in the Annexure is as under:

S. No.	Section	Information rows	Schedules Applicable
1.	Basic Details	01-06	
2.	Legal	07-08	
3.	Management	9	
4.	Commencement of Activities	10	
5.	Details of place where books of accounts and other documents have been maintained	11	
6.	Voluntary Contribution	12-20	
7.	Income to be applied	21-22	
8.	Application of Income	23-24	TDS Disallowed, 40A(3), 40A(3A),
9.	Section 115BBI	25	
10.	Section 115BBC	26	
11.	Application of Income out of different sources	27	
12.	Persons referred to in Section 13(3)	28-29	
13.	Specified Violation	30-31	
14.	TDS/TCS as per the Provisions of Chapter VII-B or Chapter VII-BB	32	Schedule TDS/TCS, Statement of TDS/ TCS, Interest on TDS/ TCS,

Overview of Annexure to Form 10B

The Annexure to Form 10B is a statement of particulars that forms part of the audit report. The auditor is required to give an opinion on whether the particulars given in the Annexure are true and correct, subject to the observations or qualifications, if any. The Form 10B consists of a number of sections, each section has either one or more rows requiring information to be furnished against that particular section. In some cases, schedules (total twenty-nine schedules) are required to be filled in as applicable.

A significant portion of Form 10B is identical to Form 10BB. However, upon comparing the two annexures, it is apparent that additional information is required in Form 10B, which can be summarized as follows:

- a) Additional sections are required to be filled with or without schedule.
- b) Additional details for certain sections already covered in form 10BB.

a) Additional sections included in Form 10B

A snapshot of additional sections asked in the Annexure is as under:

S. No.	Section	Information rows	Schedules Applicable
1.	Registration Details	9	
2.	Objects	11-12	
3.	Advancement of GPU	15-16	
4.	Business Undertaking	17	
5.	Business Incidental to Objects	18	
6.	TDS on Receipts	19	
7.	Other Income	35	Schedule Corpus
8.	Capital Assets	36	
9.	13(10) and 22 nd proviso to section 10(23C)	39	Schedule TDS Disallowable, 40A(3), 40A(3A)
10.	Expenditure incurred for religious purposes	40	

b) Additional details for the sections already covered in Form 10BB

The additional details required for the common sections which are already covered in Form 10BB are summarised in **Annexure 1** enclosed here with.

THE ADDITIONAL DETAILS REQUIRED IN FORM 10BB

Sl. No.	Section	Form 10BB	Form 10B	Additional info required in 10B	Schedules Applicable
1.	Commencement of Activities	10	13	Status, date and URN of registration.	
2.	Details of place where books of accounts and other documents have been maintained	11	14	Nature of books of accounts, whether maintained in computer system and whether books have been audited.	
3.	Voluntary Contribution	12-20	21-27	1) Donations not reported in Form 10BD to be further grouped into donations received u/s 80G, Donation in kind, anonymous donation, etc.	Schedule Corpus, FC
				2) VC forming part of corpus classified into:	
				i) Corpus donation for temples u/s 80G (2)(b)	
				ii) Other Corpus donation invested in specified mode as per 11(5)	
4.	Application of Income	23-24	31-32	1) Application of Income to be classified purpose-wise with bifurcation of each purpose into electronic and other than electronic as per Rule 6AABA	Schedule Corpus, LB, TDS Disallowed, 40A(3), 40A(3A), DI & DA, AC & ACA
				2) Details for application in excess of 50 lacs required.	
				3) Bifurcation of application into Capital and revenue.	
5.	Section 115BBI	25	33	Details of various income u/s 115BBI to be specified.	
6.	Application of Income out of different sources	27	37-38	1) Source of application to be further classified into electronic modes and other than electronic modes referred in Rule 6AABA.	Schedule Corpus, LB, AC, DI
				2) Details for application in excess of 50 lacs to a single person.	

Sl. No.	Section	Form 10BB	Form 10B	Additional info required in 10B	Schedules Applicable
7.	Persons referred to in 13(3)	28-29	41-42		Schedule SP-a, SP-b, SP-c, SP-d, SP-e1/e2, SP-f1/f2, SP-g, SP-h
8	Specified Violation	30-31	43-44		Schedule Other Violation
9	Others (Independent)	26,32	20, 45-49	Additional information regarding deduction claimed u/s 10 other than 10(1),10(23C), 10(46) and whether loan taken/repaid in violation of 269SS, 269T and amount received exceeding the limit specified in section 269ST.	Schedule TDS/TCS, Statement of TDS/TCS, Interest on TDS/TCS, 269SS, 269ST, 269T

Extension of Date for Filing Form 10A and 10AB

Background and Context

As per the new registration scheme effective from 1st April, 2021, all the existing trusts were required to apply for registration/approval, initially within three months i.e., on or before 30.06.2021. However, on consideration of difficulties in the filing of Form No. 10A, the Central Board of Direct Taxes (the Board) in exercise of the powers conferred upon it under Section 119 of the Act had extended the due date for filing Form No. 10A till 25.11.22 vide Circular No. 22 of 2022 dated 01.11.2022. However, many organisations missed the date for getting their 12AA, 10(23C) and 80G registration renewed and lost their exempt status.

Many organisations received tax demand for assessment year falling after 1st April 2021 and also became subject to cancellation proceedings and were also subjected to Exit Tax under section 115TD after the amendment made by Finance Act, 2023. In other words, genuine charitable organisations not only lost the exempt status but also were subjected to tax demands. The reason for all the miseries was failure to file renewal application in time.

Similarly, many organisations which were provided provisional registration failed to apply for converting into regular five-year registration in Form 10AB within 6 months of commencement of activity or 6 months prior to the end of the provisional registration period. There are instances where the CIT(Exemption) rejected the application for

five-year registration due to delay in filing of Form 10AB and consequently such organisations also lost their exempt status.

CBDT has issued a Circular No. 6 of 2023 dated 24th May 2023 (enclosed as **Annexure 1**) providing great relief to all such trust and NGOs by extending the date for filing of Form 10A and Form 10AB upto 30th September 2023. This Circular also addressed certain practical difficulties arising out of amendment made by Finance Act 2023.

The issues arising out of the CBDT Circular and the various other relief granted have been discussed in this issue.

Summary of Circular

The Extension of due date of Filing of Form 10A and Form 10AB extended to 30.09.2023. It may be noted that Form 10A was required to be filed by all organisations having section 12AB, section 10(23C) and 80G registration valid as on 31st March 2021. The Form 10AB was required to be filed within 6 months of commencement of activity or 6 months prior to the end of provisional registration period by all those organisations which had obtained provisional registration.

It may be noted that the extension of date for filing Form 10A has been extended to 30.09.2023, so that all the three types of registration/approval i.e. under section 12AA, section 10(23C), and 80G having validity as on 31st March, 2021 can apply for registration/reapproval in terms of new scheme of

registration. It may also be noted that the extension of date for filing Form 10A has been extended to 30.09.2023 for all the three types of registration/approval i.e. under section 12AA, section 10(23C), and 80G.

It may be noted that the extension of date for filing Form 10AB has been extended to 30.09.2023 only for registration/approval i.e. under section 12AB and section 10(23C). There is no such extension for registration under Section 80G.

All pending applications in Form 10AB with CIT(E) shall be considered as valid applications. Further, all applications which were rejected earlier, solely on account of missing of due date, shall be considered again on submission of fresh Form 10AB.

The exit tax proceedings under Section 115TD will not be applicable for all applications made till 30.09.2023.

It is clarified that the provisional approval or provisional registration shall be effective from the assessment year relevant to the previous year in which the application is made and shall be valid for a period of three assessment years.

The due date for furnishing of statement of donation in Form No. 10BD and the certificate of donation in Form No. 10BE in respect of the donations received during the financial year 2022-23 has been extended to 30.06.2023.

The statement of accumulation in Form No. 10 and Form No. 9A is required to be furnished at least two months prior to the due date of furnishing return. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return.

Account payee cheque drawn on a bank or an account payee bank draft shall also be included in "electronic modes" in Form 10B and Form 10BB.

Organisations Who Did Not Apply for Fresh Registration/Approval Under Section 12AB, 10(23C), and 80G

As per the new registration scheme effective from 1st April, 2021, all the existing trusts were required to apply for registration/approval on or before 30.06.2021. However, on consideration of difficulties in the electronic filing of Form No. 10A, the CBDT had made several extension of the due date for filing Form No. 10A as under:

- to 31.08.2021 vide Circular No.12 of 2021 dated 25.06.2021,
- to 31.03.2022 vide Circular No. 16 of 2021 dated 29.08.2021,
- and further till 25.11.22 vide Circular No. 22 of 2022 dated 01.11.2022.

Such registration/approval shall be valid for a period of 5 years. Thus, all trust existing as on 31.03.2021 were required to apply for fresh registration/approval and once the registration/approval is granted, it is valid for five years.

Several trusts failed to file Form 10A within the extended due date, in order to mitigate genuine hardship, the CBDT, in exercise of the power under section 119 of the Act, extends the due date of making an application as under:

- **If no application for fresh registration/approval is made so far**

Form No. 10A, in case of an application under clause (i) of the first proviso to

clause (23C) of section 10 or under sub-clause (i) of clause (ac) of subsection (1) of section 12A or under clause (i) of the first proviso to sub-section (5) of section 80G of the Act, till 30.09.2023 where the due date for making such application has expired prior to such date.

- **Trust who have missed the deadline of 25/11/2022 and subsequently applied for provisional registration/approval**

It is also clarified that where trusts have missed the deadline of 25.11.2022, for making an application for registration/approval in Form No. 10A, and have subsequently furnished Form No. 10A seeking provisional registration/approval, the relevant functionality on the e-filing portal may be used for surrendering the Form No. 10A seeking provisional registration/approval and such trusts can make a new application in Form No. 10A for registration/approval within the extended period up to 30.09.2023.

Provisionally Registered Organisations Who Failed to Apply for Conversion into Regular Registration Within Due Date

All new trusts are required to apply for provisional registration/approval at least one month prior to the commencement of the previous year relevant to the assessment year from which the said registration/approval is sought. Such provisional registration/approval is valid for a maximum period of three years.

Such provisionally registered/approved trusts are required to apply again for regular registration/approval in Form No. 10AB at least six-months prior to the expiry of the period of provisional registration/approval or

within six months of the commencement of activities, whichever is earlier. Many organisations missed the dead line for applying for regular registration and in such cases the CBDT Circular dated 24.05.2023 provides as under:

- **If no application has been made so far:**

Form No. 10AB, in case of an application under clause (iii) of the first proviso to clause (23C) of section 10 or under sub-clause (iii) of clause (ac) of subsection (1) of section 12A of the Act, till 30.09.2023 where the due date for making such application has expired prior to such date.

- **If application has already been made but beyond the specified time line but order is yet to be passed**

It may also be noted that the extension of due date as mentioned above shall also apply in case of all pending applications under clause (iii) of the first proviso to clause (23C) of section 10 or sub-clause (iii) of clause (ac) of subsection (1) of section 12A of the Act, as the case may be. Hence, in cases where the trust has already made an application in Form No. 10AB under the said provisions but such application has been furnished after 30.09.2022 and, where the Principal Commissioner or Commissioner has not passed an order before the issuance of this Circular, the pending application in Form No. 10AB may be treated as a valid application.

- **If application made in form 10AB has been rejected solely on the ground that application was furnished after the due date**

Further, in cases where the trust had already made an application in Form No. 10AB, and where the Principal Commissioner or Commissioner has passed an order rejecting such application, on or before the issuance of this Circular, solely on account of the fact that the application was furnished after the due date, the trust may furnish a fresh application in Form No. 10AB within the extended time i.e. 30.09.2023.

Exit Tax Under Section 115TD Will Not Apply

The Finance Act, 2023 has, inter-alia, amended section 115TD of the Act and provided that the Trust who failed to apply for re-registration/approval or failed to apply for converting provisional registration to regular registration, within the specified time, shall be made liable to tax in accordance with the provisions of section 115TD of the Act. This amendment has come into effect from 01.04.2023 and therefore applies to assessment year 2023-24 and subsequent assessment years.

It is clarified that the trusts may now apply for registration/approval under clause (i) or clause (iii) of the first proviso to clause (23C) of section 10 or sub-clause (i) or sub-clause (iii) of clause (ac) of sub-section (1) of section 12A of the Act by 30.09.2023 and where such application is made by the said date and registration/ approval is granted, the provisions of clause (iii) of sub-section (3) of section 115 TD of the Act shall not apply on account of delay in making application in accordance with the provisions of clause (i) or (iii) of the first proviso to clause (23C) of section 10 or sub-clause (i) or (iii) of clause (ac) of sub-section (1) of section 12A of the Act.

Statement of Donation & Certificate of Donation for the FY 2022-23; Timeline

Extended to 30th June, 2023

The deduction under section 80G of the Act in respect of a donation made by a donor to a fund or institution referred to in sub-clause (iv) of clause (a) of subsection (2) of section 80G, shall be allowed to the donor only if a statement of such donations is furnished by the donee in Form 10BD. The certificate of such donation is required to be provided in Form No. 10BE. Further, Form No. 10BD and Form No. 10BE are required to be furnished on or before the 31st May, immediately following the financial year in which the donation is received.

In view of extension provided to funds or institutions seeking approval under subsection (5) of section 80G of the Act, as discussed in paragraph 5(i), in the exercise of the power under section 119 of the Act, the CBDT has also extended the due date for furnishing of statement of donation in Form No. 10BD and the certificate of donation in Form No. 10BE in respect of the donations received during the financial year 2022-23 to 30.06.2023.

Provisional Registration/Approval shall be Effective from the Assessment Year Relevant to the Previous Year in Which Application is Made

The CBDT Circular clarified that in case of trusts, funds or institutions seeking provisional approval or provisional registration, the said provisional approval or provisional registration shall be effective from the assessment year relevant to the previous year in which the application is made and shall be valid for a period of three assessment years subject to the provisions of clause (iii) of the first proviso to clause (23C) of section 10 or in sub-clause (iii) clause (ac) of sub-section (1) of section 12A or clause (iii) of the first proviso to sub-section (5) of section 80G of the Act, as the case may be.

Accumulation/Deemed Application Will Not Be Denied, If Form 9A or Form 10 is Not Filed by Due Date but Filed Before Due Date of Filing of Return

The Finance Act, 2023 has made amendments to provide that Form 9A and Form 10 shall be filed at least two months prior to the due date of furnishing return of income, under sub-section (1) of section 139. The Circular has clarified that the statement of accumulation in Form No. 10 and Form No. 9A is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in sub-section (1) of section 139 of the Act.

Clarification on Electronic Mode for the Purpose of Form 10B & 10BB

The Circular clarified that for the purposes of Form No. 10B and Form No. 10BB electronic

modes referred to in para 18 are in addition to the account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account. The Rule 6ABBA of the Income-Tax Rules, 1962 covers the following under electronic modes:

- (a) Credit Card;
- (b) Debit Card;
- (c) Net Banking;
- (d) IMPS (Immediate Payment Service);
- (e) UPI (Unified Payment Interface);
- (f) RTGS (Real Time Gross Settlement);
- (g) NEFT (National Electronic Funds Transfer); and
- (h) BHIM (Bharat Interface for Money) Aadhar Pay.

**Annexure 1: CIRCULAR NO. 6 OF 2023
DATED 24.05.2023**

F. No.370133/06/2023-TPL
Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes
(TPL Division)

Dated: 24th May, 2023

Sub: Clarification regarding provisions relating to charitable and religious trusts - reg.

1. Income of 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 of the Income-tax Act, 1961 ("the Act") or any trust or institution registered under section 12AA or section 12AB of the Act (hereinafter referred to as "the trust") is exempt subject to the fulfilment of the conditions provided under relevant sections of the Act. Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 amended the provisions related to application by a trust for registration or approval by amending the first and second proviso to clause (23C) of section 10, clause (ac) of sub-section (1) of section 12A of the Act, inserting section 12AB of the Act and amending the first and second proviso to sub-section (5) of section 80G of the Act. The amended provisions provide for the following:

- (a) All the existing trusts were required to apply for registration/approval on or before 30.06.2021. However, on consideration of difficulties in the electronic filing of Form No. 10A, the Central Board of Direct Taxes (the Board) in exercise of the powers conferred upon it under Section 119 of the Act extended the due date for filing Form No. 10A in such cases to 31.08.2021 vide Circular No.12 of 2021 dated 25.06.2021, to 31.03.2022 vide Circular No. 16 of 2021 dated 29.08.2021 and further till 25.11.22 vide Circular No. 22 of 2022 dated 01.11.2022. Such registration/approval shall be valid for a period of 5 years. Thus, existing trusts are required to apply for fresh registration/approval and once the registration/approval is granted it is valid for five years.
- (b) New trusts are required to apply for provisional registration/approval at least one month prior to the commencement of the previous year relevant to the assessment year from which the said registration/approval is sought. Such provisional registration/approval is valid for a maximum period of three years.
- (c) Provisionally registered/approved trusts will again need to apply for regular registration/approval in Form No. 10AB at least six months prior to the expiry of the period of provisional registration/approval or within six months of the commencement of activities, whichever is earlier. This registration/approval is valid for a period of five years. On consideration of

difficulties in electronic filing of Form No.10AB, the Board in exercise of its powers under section 119 of Act extended the due date for electronic filing of Form No. 10AB to 30.09.2022 vide Circular No 8 of 2022 dated 31.03.2022.

- (d) The trusts once approved/registered for five years are required to apply at least six months prior to the expiry of the period of five years.
- (e) The deduction under section 80G of the Act in respect of a donation made by a donor to a fund or institution referred to in sub-clause (iv) of clause (a) of sub-section (2) of section 80G, shall be allowed to the donor only if a statement of such donations is furnished by the donee in Form 10BD. The certificate of such donation is required to be provided in Form No. 10BE. Further, Form No. 10BD and Form No. 10BE are required to be furnished on or before the 31st May, immediately following the financial year in which the donation is received.

2. Representations received from stakeholders requesting for clarity on provisions related to trusts are dealt with as under:

Clarification regarding application of section 115TD for failure to apply to registration/approval

3. Finance Act, 2023 has, *inter-alia*, amended section 115TD of the Act, so as to provide that the accreted income of the trusts not applying for registration/ approval, within the specified time, shall be made liable to tax in accordance with the provisions of section 115TD of the Act. This amendment has come into effect from 01.04.2023 and therefore applies to assessment year 2023-24 and subsequent assessment years.

4. Representations have been received stating that several trusts have not been able to apply for registration/ approval within the required time due to genuine hardship. This has also led to rejection of applications simply on the ground that these were delayed. As mentioned in para 1(a) above, the last date for filing an application by the existing trusts seeking registration/ approval was extended to 25.11.2022 vide Circular No. 22 of 2022 dated 01.11.2022. Further, as stated in 1(c) above, the due date for furnishing application for registration/approval by the provisionally registered/approved trusts was extended till 30.09.2022. These trusts shall be subject to tax under section 115TD of the Act in accordance with the provisions of the said section, as amended by the Finance Act, 2023 if the application is not made by 25.11.2022 or 30.09.2022, as the case may be.

5. In order to mitigate genuine hardship in such cases, the Board, in the exercise of the power under section 119 of the Act, extends the due date of making an application in,-

- (i) Form No. 10A, in case of an application under clause (i) of the first proviso to clause (23C) of section 10 or under sub-clause (i) of clause (ac) of sub-section (1) of section 12A or under clause (i) of the first proviso to sub-section (5) of section 80G of the Act, till 30.09.2023 where the due date for making such application has expired prior to such date;

(ii) Form No. 10AB, in case of an application under clause (iii) of the first proviso to clause (23C) of section 10 or under sub-clause (iii) of clause (ac) of sub-section (1) of section 12A of the Act, till 30.09.2023 where the due date for making such application has expired prior to such date.

6. In view of the above, trusts may now apply for registration/approval under clause (i) or clause (iii) of the first proviso to clause (23C) of section 10 or sub-clause (i) or sub-clause (iii) of clause (ac) of sub-section (1) of section 12A of the Act by 30.09.2023 and where such application is made by the said date and registration/approval is granted, the provisions of clause (iii) of sub-section (3) of section 115TD of the Act shall not apply on account of delay in making application in accordance with the provisions of clause (i) or (iii) of the first proviso to clause (23C) of section 10 or sub-clause (i) or (iii) of clause (ac) of sub-section (1) of section 12A of the Act.

7. It may be also noted that the extension of due date as mentioned in paragraph 5(ii) shall also apply in case of all pending applications under clause (iii) of the first proviso to clause (23C) of section 10 or sub-clause (iii) of clause (ac) of sub-section (1) of section 12A of the Act, as the case may be. Hence, in cases where the trust has already made an application in Form No. 10AB under the said provisions but such application has been furnished after 30.09.2022 and where the Principal Commissioner or Commissioner has not passed an order before the issuance of this Circular, the pending application in Form No. 10AB may be treated as a valid application. Further, in cases where the trust had already made an application in Form No. 10AB, and where the Principal Commissioner or Commissioner has passed an order rejecting such application, on or before the issuance of this Circular, solely on account of the fact that the application was furnished after the due date, the trust may furnish a fresh application in Form No. 10AB within the extended time provided in paragraph 5(ii) i.e. 30.09.2023.

8. It is also clarified that where trusts have missed the deadline of 25.11.2022, as mentioned in para 1(a) above, for making an application for registration/ approval in Form No. 10A, and have subsequently furnished Form No. 10A seeking provisional registration/approval, the relevant functionality on the e-filing portal may be used for surrendering the Form No. 10A seeking provisional registration/approval and such trusts can make a new application in Form No. 10A for registration/ approval within the extended period up to 30.09.2023, as mentioned in paragraph 5(i).

Extension of due date for furnishing of Form No. 10BD.

9. In view of extension provided to funds or institutions seeking approval under sub-section (5) of section 80G of the Act, as discussed in paragraph 5(i), in the exercise of the power under section 119 of the Act, the Board also extends the due date for furnishing of statement of donation in Form No.

10BD and the certificate of donation in Form No. 10BE in respect of the donations received during the financial year 2022-23 to 30.06.2023.

Clarification regarding applicability of provisional registration

10. Eighth proviso to clause (23C) of section 10 of the Act, *inter-alia*, provides that in the case of a trust referred to under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10 of the Act seeking provisional approval, such approval shall be from the assessment year immediately following the financial year in which the application is made. However, the first proviso to clause (23C) of section 10 provides that the application for provisional approval is required to be made at least one month prior to the commencement of the previous year relevant to the assessment year from which approval is sought.

11. Similarly, clause (ac) of sub-section (1) of section 12A of the Act provides that the trusts seeking provisional registration are required to make an application at least one month prior to the commencement of the previous year relevant to the assessment year from which registration is sought. However, sub-section (2) of section 12A, *inter-alia*, provides that the provisional registration shall be applicable from the assessment year immediately following the financial year in which the application for such registration is made. On the same lines, the first proviso to sub-section (5) of section 80G of the Act provides that application for provisional approval by a fund or institution is required to be made at least one month prior to the commencement of the previous year relevant to the assessment year from which approval is sought. However, the fourth proviso to sub-section (5) of section 80G, *inter-alia*, provides that the provisional approval granted under the second proviso shall be applicable from the assessment year immediately following the financial year in which the application for such registration is made.

12. With a view to bring consistency, it is hereby clarified that in case of trusts, funds or institutions seeking provisional approval or provisional registration as referred to in para 10 and 11, the said provisional approval or provisional registration shall be effective from the assessment year relevant to the previous year in which the application is made and shall be valid for a period of three assessment years subject to the provisions of clause (iii) of the first proviso to clause (23C) of section 10 or in sub-clause (iii) clause (ac) of sub-section (1) of section 12A or clause (iii) of the first proviso to sub-section (5) of section 80G of the Act, as the case may be.

Clarification regarding denial of exemption in case where the statement of accumulation is not filed by the due date.

13. Finance Act, 2023 has amended sub-section (2) of section 11 of the Act to provide that statement of accumulation as referred to in clause (a) of said sub-section [Form No. 10] is required to be furnished at least two months prior to the due date of furnishing return of income under sub-

section (1) of section 139. Similarly, the provisions of Explanation 3 to the third proviso to clause (23C) of section 10 of the Act have also been amended. Further, the due date for furnishing the option for deemed application of income in Form No. 9A under clause (2) of the Explanation 1 to sub-section (1) of section 11 of the Act has also been amended to be at least two months prior to the due date of furnishing return of income, under sub-section (1) of section 139.

14. Representations have been received that the trusts may not be able to furnish Form No. 10 and Form No. 9A before the finalisation of their computation of income. Since the computation of income is finalised at the time of furnishing of return of income, therefore, the trusts should be allowed to furnish Form No. 10 and Form No. 9A by the due date of furnishing their income tax return.

15. It is clarified that the statement of accumulation in Form No. 10 and Form No. 9A is required to be furnished at least two months prior to the due date of furnishing return of income so that it may be taken into account while auditing the books of account. However, the accumulation/deemed application shall not be denied to a trust as long as the statement of accumulation/deemed application is furnished on or before the due date of furnishing the return as provided in sub-section (1) of section 139 of the Act.

Clarification regarding audit report to be furnished in Form No. 10B.

16. One of the conditions required to be fulfilled by the trusts to be eligible to claim exemption, under the relevant provisions of the Act, is that where the total income of any trust, as computed under the Act, without giving effect to the provisions of section 11 and section 12 of the Act or the provisions of the sub-clauses (iv), (v), (vi) and (via) of clause (23C) of section 10 of the Act, as the case may be, exceeds the maximum amount which is not chargeable to income-tax in any previous year, it is required to get its accounts audited.

17. In order to rationalise the provisions related to audit report of trusts and in view of the significant amendments made to the taxation of trusts over the past few years, revised audit report in Form No. 10B and Form No. 10BB have been notified vide Notification No. 7 of 2023 dated 21.02.2023 so as to provide that the report of audit of the accounts of a trust, shall be furnished in –

- (a) Form No. 10B where,
 - (i) the total income of trust, exceeds Rs five crores during the previous year; or
 - (ii) such trust has received any foreign contribution during the previous year; or
 - (iii) such trust has applied any part of its income outside India during the previous year;
- (b) Form No. 10BB in other cases.

18. With regard to the above it may be noted that Form No. 10B and Form No. 10BB requires the auditor to bifurcate certain payments or application in electronic modes and non-electronic modes. The

Notes to the said Forms provide that electronic modes shall be the following modes referred in rule 6ABBA of the Income-tax Rules, 1962:

- (a) Credit Card;
- (b) Debit Card;
- (c) Net Banking;
- (d) IMPS (Immediate Payment Service);
- (e) UPI (Unified Payment Interface);
- (f) RTGS (Real Time Gross Settlement);
- (g) NEFT (National Electronic Funds Transfer); and
- (h) BHIM (Bharat Interface for Money) Aadhar Pay.

19. It has been represented that the above description of electronic modes does not include account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

20. It is hereby clarified that for the purposes of Form No. 10B and Form No. 10BB electronic modes referred to in para 18 are in addition to the account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

21. Hindi version to follow.



(Vipul Agarwal)

Director (TPL-I), CBDT

Copy to the:

1. PS/ OSD to FM/ PS/OSD to MoS (F).
2. PS to the Finance Secretary.
3. Chairman and Members, CBDT.
4. Joint Secretaries/ CsIT/ Directors/ Deputy Secretaries/ Under Secretaries, CBDT.
5. C&AG of India (30 copies).
6. JS & Legal Adviser, Ministry of Law & Justice. New Delhi.
7. Institute of Chartered Accountants of India.
8. CIT (M&TP). Official Spokesperson of CBDT.
9. ADG (Systems) -4 for uploading on departmental website.
10. JCIT, Database Cell for uploading on irsofficeronline.gov.in.
11. All PrCCITs.



(Vipul Agarwal)

Director (TPL-I), CBDT

Allocation of Common Costs

Introduction:

Non-Governmental Organizations (NGOs) play a vital role in addressing social issues and driving positive change in society. To achieve their objectives, NGOs incur various costs, including both direct and indirect expenses. The allocation of common costs stands as a critical challenge that demands both financial precision and strategic decision-making. As NGOs strive to fulfil their missions and deliver impactful programs, understanding how to fairly distribute expenses that benefit multiple activities assume paramount significance. For the common cost allocation, organization needs to explore the dual lenses of accounting and budgeting to shed light on best practices, potential pitfalls, and the delicate equilibrium between financial accountability and effective resource distribution.

Understanding Common Costs:

A common cost is a cost that will be incurred irrespective of any project or program being implemented by the organization or we can simply say that these costs will be incurred even if the organization does not have any project as the benefits of these costs are for more than one project. For example - website maintenance, accounting software licenses, etc. Hence, these costs are not directly attributable to a specific program or project but are incurred for the overall functioning and administration of the organization. This implies that the allocation of cost should be done in an equitable manner to avoid situations where some programs are

disproportionately burdened with common costs while others receive an undue advantage. Thus, it is important for organizations to costs while others receive an undue advantage. examine the basis of cost allocation.

Importance of Cost Allocation:

Allocation of costs is important for enhancing financial transparency and accountability in the organization as it will ensure that the true cost of delivering programs and services is accurately reflected. However, the allocation of common costs is not solely an accounting concern but also an important aspect of budgeting. During the budgeting process, organization must consider the allocation of common costs among programs to ensure that there is fairness in cost allocation thereby adequately allocating the common cost in the budget. Further, proper allocation of common costs will help the organization to comply with the requirements set forth by the financing partner.

Challenges in Allocating Common Costs:

Allocating common costs can be challenging due to the following: -

1. **Cost Attribution:** Determining how to allocate common costs fairly and accurately among different programs and functions can be a challenging task. It requires identifying appropriate basis of allocation that reflects the underlying factors driving the costs.

2. **Program Diversity:** Organizations often operate multiple programs with different objectives, activities, and funding sources. Each program may have unique cost drivers and resource requirements, making it challenging to distribute common costs accurately and equitably.
3. **Resource Constraints:** Sometimes, the limited financial and human resources may also pose challenges in implementing cost allocation methodologies. Hence, organization need to strike a balance between accuracy and practicality to ensure cost-effective operations.

Basis of Allocation:

In order to determine the basis of allocation, ascertaining the various common costs of the organization is crucial. Thus, to identify the common cost, categorization of the cost as direct costs or indirect costs is important.

Direct Costs: are expenses that can be easily and specifically attributed to a particular program, project, or activity. These costs are directly related to the execution or implementation of a specific program, and their allocation to that program is straight forward. Direct costs can include items such as: Salaries or wages of staff members dedicated solely to a specific program, supplies or materials specifically used for a particular project, equipment or resources directly allocated to a program, etc. They have a clear and traceable connection to the program's objectives and activities.

Indirect Costs: also known as overhead costs or shared costs that cannot be easily attributed

to a specific program or project. These costs benefit the organization as a whole or multiple programs simultaneously, making their allocation a challenging task. Examples of indirect costs include: administrative salaries and wages of employees who work across various programs, rent, utilities, and maintenance expenses for shared office spaces or facilities, etc. Indirect costs are necessary for the overall functioning and support of the organization and its programs. Allocating these costs typically requires the use of allocation methods or pre-determined rates based on factors such as staff time, program budget size, or other allocation basis. These allocation methods aim to distribute indirect costs fairly among the programs based on a reasonable and consistent basis.

It is important to note that there is no exhaustive list of costs that must be considered as indirect costs or direct costs. The organization needs to analyze that if there are no projects currently underway, whether these resources are still required to maintain essential functions and prepare for future projects. For instance - the presence or absence of specific projects does not eliminate the need for administrative support, a functioning office space, or basic operational expenses. This implies the cost which is direct for an organization may be considered as an indirect cost by another organization. For example, purchase of stationery by the organization - if the stationery is purchased for distribution to the beneficiaries, it will be considered as a direct cost, however, if it is purchased for the use at the organization, it is an indirect cost. Hence, the direct or indirect nature of a cost depends on the extent to which it can be directly allocated to a specific program or whether it supports the broader

organizational functioning as a whole.

With this it is quite evident that the organization must establish clear guidelines and methodologies for distinguishing between direct and indirect costs and ensure proper documentation and transparency in the allocation process.

Once the common costs are derived, the basis of allocation needs to be identified. The most important aspect to remember is that allocating costs according to available budgets is incorrect way of cost allocation. Organization needs to think rationally about how the resources that are represented by the costs are actually used or benefitting the different projects. There are various methods for allocation of costs. However, the choice of method depends on factors such as the nature of the costs, the organization's activities, and best practices followed in the development sector. So, one way could be the Direct Allocation method wherein costs that are directly attributed to specific programs or activities may be allocated. For example, if an organization rents a separate office space exclusively for a particular program, the entire rental cost can be allocated directly to that program. However, where the office space is being used for implementation of multiple projects, i.e. if multiple programs are being implemented in the same office space etc., proportionate allocation method could be adopted in such cases. In this method, cost allocation could be based on the relative usage of resources by different programs. Now, taking the same example of one office space being used for implementing multiple programs, the allocation could be based on the number of work station used for each project or number of staff using the area in each

program. Similarly, for staff working for multiple projects, way of cost allocation could be personnel time and effort. Costs may be allocated based on the amount of time and effort each personnel spends on specific programs. This method involves tracking and documenting the time spent by employees on different activities and allocating costs accordingly. It may involve using timesheets or other similar systems to record and track personnel time.

Therefore, there could be multiple ways of allocating common costs.

The key points to be kept in mind while allocating the common costs are: -

1. **Reasonableness:** The allocation method should be reasonable and justifiable. It should reflect a fair distribution of costs based on factors such as resource usage, benefit received, or other relevant criteria like personnel time, square footage of space used, or direct program expenses. In simple terms, the basis should have a logical connection to the cost being allocated.
2. **Documentation:** Proper documentation is crucial for cost allocation. The organization must keep detailed records of the allocation process, methodologies used, and any supporting documentation. This documentation will help the organization in audits, financial reporting, and demonstrating compliance with the financing partner's requirements.

3. **Clear Policies:** Establishment of clear policies and guidelines for cost allocation within the organization is very important. Further, documentation of these policies and accordingly communicating them to the staff is pivotal to ensure everyone understands the principles and methodologies used for allocating common costs.
4. **Direct and Indirect Costs:** Difference between direct costs that can be easily attributed to specific programs and indirect costs that support multiple programs is important. Based on which the appropriate allocation method for each type of cost could be determined.
5. **Regular Reviews:** Periodically review of the allocation methods is significant to ensure their continued relevance and fairness. Hence, it is must to assess whether changes in programs, activities, or resource usage necessitate adjustments to the allocation methodology.

Conclusion:

The allocation of common costs is a complex yet essential aspect of project financial management for organizations. Proper allocation ensures accurate financial reporting, supports effective budgeting, and enhances accountability to stakeholders. Organizations must carefully consider the challenges involved in allocating common costs, thereby developing a strategic balance to ensure deriving at a rational basis of allocation and adherence to financial management best practices along with compliance of the financing partner requirements. By adopting transparent, and flexible allocation methodologies, and regularly reviewing, and adjusting processes, organization can optimize resource utilization and enhance their impact in achieving their mission and objectives.

Designing Governance Manual

Introduction:

Every organization has a governance process which guides and controls the way it operates. In some organizations, these processes are formal and fairly well structured while in some others, they may be semi-formal. Again, there are some organizations where governance is very informal. It is also found that certain organizations do not make a distinction between governance and management as well.

It may be clearly said that having a clear defined governance process contributes to the overall efficiency of the organization. Each step/process needs to be documented and assimilated together. One of the reference tools for the internal governance of the organization is the 'Governance Manual'.

Purpose of the Governance Manual

- Provides clarity to the Board members and the management about their roles and responsibilities.
- Provides a clear distinction between governance & Management.
- Serves as a blue print for governance of an organization.

1. Broad Contents of the Governance Manual

The Governance manual should cover the following areas:

Strategic Direction of the Organization

One of the basic duties of an NGO's board is to provide strategic direction to the organization. This includes:

- Defining organizational values and setting standards for professional conduct;
- Identifying & articulating a clear mission statement;
- Ensuring a common understanding of the mission within the organization;
- Execution of the mission through appropriately planned activities & programs; and
- Regular reviewing of the mission to ensure it aligns with existing or planned activities.

All of these should be clearly stated in the Governance Manual.

Governance Manual serves as a blue print for the Governance of the Organization.

Board members

- **Roles & Responsibilities of Board Members:** The Governance Manual should clearly identify & put forth the roles & responsibilities of the board members. Even though the Board Members govern as part of a collective leadership, they have individual duties as well, such as:

- i. Understanding & Supporting the organization's mission;
- ii. Attending meeting regularly;
- iii. Maintaining confidentiality;
- iv. Offering informed & impartial guidance; and
- v. Appointing the Chief Functionary.

A clear description of the roles & responsibilities of the Board Members in the Governance Manual would enable the members in internalizing their role and ensuring effective governance.

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Election/ Selection of Board Members: The manual should provide clear and concise guidelines with regard to the election/ selection of board members. The criteria for selecting board members, election procedures, etc. need to be clearly stated in the 'Governance Manual'. Based on the Board's functions, including representing the various constituencies, the process of selection of Board members (and their designated alternates) takes several criteria into consideration. All these issues should be addressed in the Governance Manual.

A clear description of the roles & responsibilities of the Board Members in the Governance Manual would enable the members in internalizing their role and ensuring effective governance.

- **Term of the Board Members:** The tenure of the Board Members should be clearly indicated in the manual.

- **Orientation of Board Members:** Orientation is the processes of induction wherein, new members integrate themselves into the overall organizational structure. Introducing new members to program, policies & strategic issues should form a part of the orientation process. The orientation of the Board Members can happen at three levels:

- i. **Verbal Orientation:** Verbal Orientation by other board members on the various issues, policies, strategies, activities, mission, & vision of the organization would provide a basic idea to the new member about the organization.
- ii. **Study of Various Documentation:** The various documents such as vision & mission statement, activity reports, financial statements, informational brochure or any other relevant document of the organization can be provided to the new board member.
- iii. **Field Visits:** The actual operation of the NGO can be understood by going to the field area. This would provide the new member with an overview of the ground reality. The basic guidelines about the orientation of a new board member should be provided in the governance manual.

- **Conflict of Interest:** The issue of conflict of interest is of growing concern in NGOs and the governance manual should address this issue clearly. A Conflict of Interest Policy should be in place in order to deal with a potential conflict of interest situation.

- **Reimbursement:** The service provided by the board members is voluntary and the position held by them is honorary. This is because it is crucial that board members do not derive, or be perceived as deriving, any direct or indirect benefit from their service in the board. However, reimbursement of travel expenses incurred for attending board meetings and other such expenses should be taken care of by the NGO. Further, if any of the specific skills of any particular board member are used by the NGO, then a reasonable compensation should be provided. The amount to be paid should be decided by the board in the absence of the concerned board member.

The service provided by the board members is voluntary and the position held by them is honorary.

Board Meetings

The Board should hold regular meetings to reflect and discuss on the performance of the organization and plan the future course of action. The Board meetings are also a platform for any strategic decision to be taken and any other issues that need to be dealt with. With regard to Board meeting, the Governance manual should at least include the following things:

- **Preparation & Distribution of Meeting Agenda:** For the Board meeting to be effective and fruitful, it is required that all the members are informed about the agenda for the meeting. This would help the members prepare for the meeting in advance and actively participate in the decision making process. The manual should specify this and clearly state the person responsible for the preparation and circulation of agenda.
- **Quorum:** The Manual should specify how many members constitute a quorum (minimum, number of members that must be present to make the proceedings of a meeting valid), and the manner in which decisions are taken and recorded. Such guidance helps the board perform its tasks consistently and avoid doubts about the validity of its decisions.
- **Minutes:** The record of board meetings is a basic instrument of accountability. Minutes are a form of institutional memory that enable an organization to work consistently. The board should ensure that a record of all formal proceedings, including their time and place, attendance, agenda, and decisions are maintained.
- **Appointment & Appraisal of Chief Functionary:** The Board is responsible for appointing the Chief Functionary of the NGO and delegating authority to him/her for the overall management of the organization. It is the duty of the board to see that Chief Functionary fulfils all the required criteria and is fully capable of delivering the required job role. Further, the board should also ensure the accountability of the Chief Functionary by regular appraisals. It should also provide a clear and precise job description to the Chief Functionary which will enable him/her to understand his/her role more clearly.
- **Board Appraisal:** The Board Appraisal is a process by which the board introspects and measures its own performance. These kinds of self-

assessments help a board sharpen its understanding of leadership and define the contribution it can make to the NGO. Ideally, the board should set itself annual goals and measure its own performance against these targeted goals. The frequency and the procedure of the Board Appraisal should form a part of the Governance Manual.

- **Drafting and Approving New Policies:** Since the board is primarily responsible for the governance of the NGO, it is therefore required that all the strategic issues pertaining to the NGO are clearly dealt with in the key policies of the organization. The board should ensure that all the key policies are well drafted and leave no room for doubt or confusion.

The broad contents described in above for the Governance Manual are by no means exhaustive. It just provides a brief overview of the major areas that need to be addressed in the Manual.

Who Should Prepare Governance Manual?

The primary responsibility of preparing the Governance Manual is of the board. However, they should also receive necessary feedback from the Chief Functionary and other senior staff members.

2. Conflict of Interest Policy

A conflict of interest may be defined as the existence of interest in different capacities of any person in the same decision. For instance, an organisation may take on rent the property belonging to one of the Directors; when such decision is taken, then the concerned Director is having simultaneous interest in dual capacity. One, the concerned Director is duty bound to

find the right kind of premises at right rent for the NPO; on the other hand, the same concerned Director, being the owner of the property, is in his/her personal capacity interested to get the best possible bargain for his/her premises. In this case, there is a clear Conflict of Interest. From the NPOs point of view, the Board should bargain for the lowest possible rent and from the Director's personal point of view, he/ she should bargain for the highest possible rent. In such circumstances, it is desirable that the concerned director should not participate in the decision-making.

Whenever there is conflict of interest, the interested person should not participate in such decision-making. In other words, one should not act as the service provider as well as the service taker at the same time.

All the important persons in an organisation, who can influence the decision-making, are required to exercise their skills and abilities in a honest and prudent way for the benefit of the organisation. They should not use their power or authority for their personal benefit, directly or indirectly. Therefore, it is important that all organisation should have appropriate conflict of interest policy.

Instances of Conflict of Interest

There should be a clearly defined policy to ensure that any conflict of interest is properly dealt with. The issues which may be regarded as material interest are as under:

- Appointment of relatives in Board or senior management.
- Ownership or partial ownership in organisations which are engaged or may seek business or consultancies.
- Payment of fees and remuneration.

- Directorship or management position in other NPOs.
- Providing consultancies in personal capacities.
- Having commercial interest in any decision or resolution.
- Having direct or indirect relationship with the donor or donee organisations.
- When contracts are awarded to relatives of the Board members.
- Persons supplying goods and services to the organisation are relatives of interested person.

The Board of Directors or the Trustees should declare such interests. The interested Trustees and Directors should not participate in the decision making and voting process for that particular resolution. An annual declaration of such interests should be placed in the annual general meeting.

It is also important to define who the interested persons are. Normally, the Board Members and Trustees are considered to be the interested person, but there may be other category of person who should also be covered under 'conflict of interest policy'. Such persons could be the CEO, Senior Managers, Major Donor, and Sister concern, etc.

Further, the various statutes applicable to the NPO may also prescribe conditions regarding the various conflict of interest transactions. Therefore, it is important to analyses such requirements under various statutes, for instance, the Income Tax Act in India is very strict and prohibits any kind of benefit to any interested persons. It further requires disclosures of all legitimate and permissible

transactions with interested person.

Normally, it is permissible to have reasonable and legitimate transaction with interested person. However, proper disclosures and decision-making processes should be followed while entering into any such conflict of interest transactions.

Who are Interested Persons?

As discussed earlier, apart from the Board of Directors or the Trustees, various other person can also be considered as an interested person. An illustrative list is as follows:

1. Author of the Trust or Founder(s) of the institution;
2. Board of Directors or the Trustees;
3. Any CEO or Senior Management person (by whatever name called) of the institution;
4. Person who has made a substantial contribution to the Trust or Institution. Each organisation may set a limit beyond which the donor would be considered as an interested person;
5. Any relative of any such author, founder, person, member, Trustee or manager as aforesaid;
6. Any concern or organisation in which any of the persons referred to in (1) to (5) above has a substantial interest.

Who is a 'Founder'?

It is important to understand the implication of the scope of the term '*founder*' for the purposes of identifying interested person. In case of Societies and Not for Profit Companies, the persons who subscribe to the

memorandum of association can be described as the founders of the organisation. The Chambers *Twentieth Century Dictionary* (1971) defines the word 'founder' as "one who founds, establishes or originates: an endower".

In our view, the persons who subscribed to the memorandum of association of the assessee-society could, therefore, be described as the "Founders" of the assessee-society. In case of Trust, the Settler and the first Trustee can be considered as the founders. The Supreme Court of India in the case *DIT v. Bbarat Diamond Bourse* [2003] 126 Taxman 365, observed that it was not necessary for the founder to have contributed any money towards the formation or running of an organisation. The Supreme Court further held that the expression 'founder of the institution' meant that 'the person concerned should be the originator of the institution, or, at least, one of the persons responsible for the coming into existence of the institution' and that contribution of money was not an inescapable test of a person being a founder', though it might often happen that person who originated an institution might often also fund it.

Who is a 'Relative'?

A "relative" may be defined as "relative, in relation to an individual, means the husband, wife, brother or sister or any lineal ascendant or descendant of that individual". Thus, the definition of the term 'relative' is enlarged one to include even the lineal ascendant or descendant of the spouse, brother, or sister of either the individual, or the spouse. However, various statutes define 'relative' differently, therefore, all NPOs should check the applicable statutes for the definition of relative, if any. If the applicable statutes are silent about the term relative, then the NPO may adopt a suitable definition of the term relative. For example, the above definition of relative can be explained as under:

- 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 (ii), (iii), (iv) or (v) above;
- vii. Any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.

Meaning of Substantial Interest

As we have already understood that any transaction with an interested person comes under the purview of 'conflict of interest'. In this context, it may also be noted that transaction with organisation or entity where an interested person has 'substantial interest' also comes under the purview of 'Conflict of Interest'. Therefore, it becomes important to understand the meaning and scope of the term 'substantial interest'.

The meaning and scope of "substantial interest" under various circumstances could be defined as under:

- The interested persons should not hold more than 20% of the shares of that concern, i.e. the interested persons should not hold more than 20% of the voting power of that concern, individually or collectively.
- The interested person should not be the Chief Functionary or be in influential

decision-making position of such concern.

- The above elaboration of "substantial interest" is indicative in nature. NPOs may have their own understanding or definition of the term "Substantial Interest".

Some Example of Conflict of Interest Transaction

A conflict of interest, as discussed above, relates to an interest or benefit, direct or indirect, provided to any persons or organisation discussed above. Some examples are given below:

- Providing advances or loan to either interested person or organisation where such person has substantial interest or to their relatives.
- Providing donations or gifts to either interested person or organisation where such person has substantial interest or to their relatives.
- Taking on lease or giving lease of buildings, property, equipment, vehicles etc. either to/from interested person or organisation where such person have substantial interest or to their relatives.
- Providing employment to either interested person or to their relatives.
- Providing consultancy contract or other commercial contracts to either interested person or organisation where such person has substantial interest or to their relatives.
- Undertaking consultancy contract or other commercial contracts from either interested person or organisation where

such person has substantial interest or to their relatives.

It may be noted that all the above transactions are not legally prohibited, an organisation may enter into the above type of transaction provided they are reasonable and legitimate. All the above transactions, should be done in compliance with the conflict of interest policy of the organisation.

Benefit to Interested Person Which is Prohibited

It may be noted that conflict of interest transaction may be done if they are reasonable and legitimate with adequate disclosures. However, no NPO can provide any benefit directly or indirectly to any interested persons. Some example of the various benefits are provided as under:

- Lending of funds to specified persons without adequate security and adequate interest. Generally, lending of funds to any individual is not permitted, but there might be circumstances where another charitable organisation might be supported. In such cases also, the lending should be made with adequate security and adequate interest.
- Making available building or property of the trust for the use of the specified persons without charging adequate rent or other compensation.
- Paying salaries or remuneration to specified persons, in excess of what may be reasonably paid for the services rendered by such persons.
- Providing services of the organization to the specified persons without adequate remuneration or other compensation.

- Purchasing services, materials, equipment or other properties from specified persons for consideration which is more than adequate.
- Selling services, materials, equipment or other properties to specified persons for consideration which is more than adequate.
- Diversion of income or property of the organization to any of the specified persons.
- Investing funds of the organization in concerns where the specified persons have substantial interest.

The above transaction will not be deemed as reasonable or legitimate and therefore, are not permitted.

Disclosure Policy and Procedure for 'Conflict of Interest' Transaction

As discussed above, it is legally possible to have transaction with parties having a conflict of interest. However, certain procedure as discussed below should be followed for approval of such transactions:

- i. The conflict of interest should be fully disclosed at the time of the initiation of transaction and also after completion of transaction in various reports and MIS as may be required/determined.
- ii. The person having conflict of interest should be excluded from the discussion and approval of such transactions.
- iii. The transaction must be through a normal competitive bid or procurement procedure as the case may be. Otherwise, justifiable reason for such transaction should be on record.

- iv. The Board or the authorized body should determine that the transaction is in the best interest of the organization. In other words, Board or the authorized body should collectively take the responsibility of such transaction.
- v. Disclosure regarding the transaction should be made to the CEO, if the transaction does not pertain any Board members or Trustees. If the CEO himself/herself is involved, then the disclosure should be made to the Board or the Executive Committee of the organisation. Such authority, before whom such disclosure is made shall make the necessary due diligence and inform the Board or General Body on case-to-case basis.
- vi. Disclosure regarding the transaction should be made to the Chairperson or the President, if the transaction pertains to any Board Members or Trustees. If the Chairperson or the President is involved, then the disclosure should be made to the Board or the General Body of the organisation. Such authority, before whom such disclosure is made, shall make the necessary due-diligence in this regard on case-to-case basis.
- vii. The Board or an authorized body shall determine whether a conflict of interest exists and whether such transaction can be treated as reasonable, fair, transparent and in the interest of the organisation.

Sample of the Minutes Record of Conflict of Interest Transaction

A sample of the minutes record involving a conflict of interest transaction could be as under:

"A motion was moved by Mr. _____

onward approval of a rent agreement for renting out the _____ property of the NPO to Mr. _____ who happens to be a Board member.

The details of the agreement and the due diligence report was placed before the Board. The members present verified the process of identifying the tenant and the adequacy of rent. It was found that the rent payable was comparable to the market rates for similar premises. The motion was second by _____. There solution was passed unanimously with a vote of 7-0 and the interested director Mr. _____ did not participate in the vote".

Honorary Director or Independent Director

The conflict of interest policy should apply equally to both the honorary paid or full time Directors of Trustees. It should not be misunderstood that conflict of interest policy applies only to paid or full time Directors of Trustees.

The term 'independent director' is more relevant in the corporate world. In the voluntary sector, most of the Directors are in any case expected to be independent. Clause 49 of the listing agreements on corporate governance defines Independent Directors as follows:

"For the purpose of this clause the expression 'Independent Directors' means Directors who apart from receiving director's remuneration, do not have any other material pecuniary relationship or transactions with the Company, its promoters, its management or its subsidiaries, which in judgment of the Board may affect independence of judgment of the Directors."

The non-executive independent Directors are not supposed to receive any financial consideration except the sitting fees.

In case of NPOs, all the Directors are not supposed to take any kind of benefit or privilege from the organisation. Therefore, in letter and spirit, all the Directors in case of NPOs are independent in nature.

However, as a concept, it needs to be ensured that the Directors or Trustees are not enjoying any undue benefit or are not involved in any conflict of interest transaction irrespective of the fact, whether they are remunerated position or honorary position.

Similarly, the same principles should be followed for ex-officio positions.

Procedure of Handling Conflict of Interest Transaction

The various issues/steps involved in a conflict of interest transaction are as under:

- An interested person should only be allowed to pursue/initiate conflict of interest transaction/decision if it qualifies under non-negotiable norms. For instance, the relative of the CEO should not be appointed as the Statutory Auditor.
- The matter should be subjected to a basic due diligence by the Executive Team, unless the matter is such that it should be addressed only at the Board level.
- The interested person may make presentation before the Board members, however, any interested director or Trustee should not be present at the time of decision-making. Such person should not be eligible to vote for such resolution.

- The Board may further investigate the matter directly or through a person or committee, to ensure that the transaction is in the best interest of the organisation.
- Once a positive finding/report is available, then the resolution may be passed with a majority vote without considering the vote of the interested person.
- The interested person should declare, on record, all the relevant information and possible conflict of interest in the transaction.

Violation of Conflict of Interest Policy

The Board or the Trustees of all NPOs should review various important transaction/decision, periodically, to ensure that all the decisions taken are in compliance with the conflict of interest policy of the organisation. The Board or the Trustees of NPOs should also ensure that there is no violation of the conflict of interest policy. In this context, the following are relevant:

- A proceeding pertaining to violation of the conflict of interest policy may be initiated if the Board or the Trustees have reason to believe that any such violation might have occurred, or the Board or the Trustees receive any written complaint with relevant facts or evidence.
- The failure of disclosure of interest by any interested person could also be a primary reason for initiating and

proceeding of violation of conflict of interest policy. It should be noticed that even if a transaction is fair and reasonable, it should still follow the conflict of interest policy and adequate disclosure should be made prior to the transaction by the interested person.

- Whenever a proceeding of violation of conflict of interest policy is initiated, it is important that the concerned interested person is provided adequate opportunity of being heard.
- The findings of any inquiry for investigation against violation of conflict of interest policy should be placed before the meeting of the Board or Trustees. The Board or Trustees may decide to take necessary disciplinary/penal action. They may also initiate appropriate legal action wherever there is a serious violation.

Conflict of Interest Disclosure Statement

All the Trustee/Directors and other interested persons should provide a conflict of interest disclosure statement annually.

Conclusion:

As mentioned earlier, the Governance Manual is a key tool for internal accountability. It should aim at precise demarcations between governance and management. It is a reference for the board members for their own conduct. A good Governance Manual provides clarity about the domain of operation for the board and hence, is responsible for effective governance.



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