

# BUDGET 2023

◆ Legal Series Vol. XV ◆ Issue 10

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## SUMMARY OF MAJOR AMENDMENTS FOR NPOs



**Standards & Norms**

Resource support on NGO Governance, Accounting and Regulations



**fmsf**

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## INTRODUCTION

- 1.01** 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. a summary which have been provided in this issue. 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 proviso to section 12A(2) as such benefit was available only to organisations registered under section 12AB.

## APPLICATION OUT OF CORPUS FUND

- 2.01** *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.
- 2.02** *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.
- 2.03** *Proposed Amendments by Finance Bill 2023:*
- It is proposed that any application made out of corpus can be 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 enure 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).

#### **2.04 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

**3.01 *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.

**3.02 *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.

**3.03 *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).

#### **3.04 *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.

## RETROSPECTIVE EXEMPTIONS BENEFIT WITHDRAWN

- 4.01 *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.
- 4.02 *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 becomes redundant.
- 4.03 *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.
- 4.04 *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

**5.01 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 are considered as application without any restriction except contribution towards corpus.

**5.02 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%.

**5.03 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.

**5.03 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		100		100
Income				
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**

**6.01** *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 sub-section (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).

**6.02 *Rationale for bringing amendment as per the memorandum explaining Finance Bill, 2023***

The memorandum explaining Finance Bill, 2023 states that because of the present time line of furnishing of return, the un intended benefit of exemption has also become available for the updated return furnished u/s. 139(8A) .

**6.03 *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).

**6.04 *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

**7.01** *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.

**7.02** *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.

**7.03** *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.

<i>Varios form</i>	<i>Due-date</i>
Filing of ITR	31 <sup>st</sup> October
Filing of Form 9A	31 <sup>st</sup> August
Filing of Form 10	31 <sup>st</sup> August

**7.04** *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 31<sup>st</sup> 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**

**8.01** *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 to 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.

**8.02** *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.

**8.03 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.

**8.04 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

**9.01 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)].



- 9.02 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.
- 9.03 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.
- 9.04 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-REGISTRTION/RENEWAL/PROVISIONAL TO REGULAR REGISTRTION

- 10.01 Background and the context of amendment:** As per the new registration requirement:
- Every existing registered organisation under section 12A/12AA need to re-register
  - 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/convertng 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.

**10.02 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.

**10.03 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.

**10.04 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 that 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.

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