BUDGET 2021

Standards & Norms
Resource support on NGO Governance, Accounting and Regulations

• Legal Series Vol. XIII • Issue 11 • February 2021

For private circulation only

MAJOR AMENDMENTS FOR NPOs

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OVERVIEW OF THE KEY CHANGES FOR NPOS IN BUDGET 2021

1.01 The Finance Bill 2021 has brought in some important changes for charitable and religious organisations which have been discussed in this issue. The text of the relevant amendments is provided in ***Annexure 1***.

1.02 ***Corpus donation subject to investment conditions :*** There has been few important changes pertaining to corpus donation. Effective from 1st April, 2021 corresponding to Assessment Year 2022-23 corpus donation received by an organisation will not be treated as exempt income unless such corpus donation is invested or deposited in one or more of the forms or modes specified in sub-section (5) of section 11 maintained specifically for such corpus. It may be noted that the condition of investing the corpus fund in section 11(5) investment shall apply only to that part of corpus fund which has been created from corpus donations exempted under section 11(1)(d), because organisations may have corpus funds invested in business assets under section 11(4) or (4A) which do not conform to the requirements of section 11(5). Further, a charitable organisation can be created with a corpus property which also does not conform to the requirements of section 11(5).

1.03 ***Application out of Corpus no longer permissible to be set-off against Current Year Income:*** Any expenditure or application made out of the corpus 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.

1.04 ***Application out of Loans and Borrowing permissible only in the year of Repayment:*** Application from loans and borrowings shall not be considered as application for charitable or religious purposes for the purposes of third proviso to section 10(23C) and clauses (a) and (b) of section 11(1). However, when loan or borrowings are repaid from the income, such repayment shall be allowed as application in the year in which it is repaid to the extent of such repayment.

1.05 ***Set-off of Past Deficit against Current Year Income :*** Set-off of past deficit against current years income will no longer be permissible for the purposes of computing 85% application.

1.06 ***Rationale behind not allowing set-off of deficit against current years income :*** Application for charitable and religious purposes can be out of three sources :

(i) Current years income

(ii) Accumulated & Unconditional own funds (Corpus of the organisation)

(iii) Borrowed funds

In any year if there is a deficit i.e. excess of expenditure over income, it would imply that the organisation has over spent out of either borrowed funds or its corpus. Such deficit, earlier, was allowed to be set-off against future income, but the Finance Bill 2021 proposes that effective from 1st April, 2021 corresponding to Assessment Year 2022-23, such deficit cannot be set-off against future income. However, an organisation will be permitted to replenish the source of such deficit against income of future years i.e. (i) to repay the funds borrowed for such expenditure which created deficit, (ii) to create investments under section 11(5) to the extent of the deficit.

1.07 ***Educational and Medical Institutions exempted upto Rs. 5 crore without any registration requirement :*** The Finance Bill 2021 has made path breaking changes in sub-clauses (iiiad) & (iiiae) of clause (23C) of the section 10 and has provided that any educational or medical institution shall be exempt from Income Tax upto a total income (turnover) of Rs. 5 crore annually. This limit was only Rs. 1 crore prior to be amendment. This is a big take away for such institutions. It may be noted that under section 10(23C)(iiiad) & (iiiae) an organisation is not required to get itself registered before any authority and is also not subject to 85% application. This amendment should immensely benefit small and medium educational or medical institutions. It appears that the Government intends to encourage NPOs which are engaged in direct delivery activities such as education and medical relief.

1.08 ***The Rs. 5 crore limit shall apply to the aggregate turnover of all institutions under the organisation :*** The Rs. 5 crore limit shall apply to the aggregate turnover of all institutions under the organisation. It may be noted earlier by virtue of certain case laws organisations were allowed Rs.1 crore limit for each of the institution run by them. For example if an organisation is running 10 schools and the turnover of each school is less than Rs. 1 crore then the benefit of exemption was available to the organisation for all the schools without any registration or approval. After this amendment the aggregate turnover of all institutions under the organisation should not exceed Rs. 5 crore limit.

1.09 ***Less time to file Belated or Revised Income Tax Returns :*** The last date of Belated or Revised Income Tax Returns has been preponed to 31st December earlier it was 31st March.

AMENDMENT PERTAINING TO CORPUS DONATION :

2.01 Under the existing provisions of the Income Tax Act, 1961, corpus donations received by trusts, institutions, funds etc. are exempt from tax without any requirement for applying them for charitable purposes. This exemption pertaining to corpus donation is available to organisations approved under clause (23C) of section 10 as well as organisation registered under erstwhile section 12AA (now section 12AB).

2.02 However, as per the proposed amendment, the Corpus Donation shall be exempt only if the amount is invested or deposited in its specified modes as per Sec 11(5) of the Income Tax Act, 1961. Necessary amendments to this effect has been made under section 11(1)(d) as well as the third proviso under clause (23C) of section 10 of the Income Tax Act, 1961.

2.03 It may be noted that the condition of investing the corpus fund in section 11(5) investment shall apply only to that part of corpus fund which has been created from corpus donations exempted under section 11(1)(d), because organisations may have corpus funds invested in business assets under section 11(4) or (4A) which

do not conform to the requirements of section 11(5). Further, a charitable organisation can be created with a corpus property which also does not conform to the requirements of section 11(5).

2.04 It may be noted that the corpus fund of an organisation may be created through many sources and may also include assets which do not conform to section 11(5). The sources from which a corpus fund could be created are broadly as under:

- Corpus donation received with the specific direction.
- 15% accumulation after applying 85% of income.
- By payment of taxes, for example an organisation pays taxes against anonymous donations in excess of 5%.
- At the time of creation of trust corpus may come as cash, property or even business.
- Corpus donation from any other exempt income not subject to application under section 11.

For the sake of greater clarity it may be noted after the amendment only the corpus fund to the extent created out of corpus donation received under section 11(1)(d) has to remain invested as per section 11(5), for example such fund cannot be used for incidental business activity which is possible with other corpus fund.

Finally, there is no specific amendment regarding the consequences if investment made out of corpus donation is liquidated in subsequent year and not re invested. In our opinion in such situation the amount realised should be treated as income subject to application otherwise the proposed amendment will be negated.

2.05 ***Donations for construction of building :*** Now onwards corpus donation would imply that the funds so received have to be retained in the form of investments. In other words, corpus donation received towards construction of building or any other asset will no longer be treated as corpus donation. For example, if some donation is received for creation of assets for project purposes then such donation cannot be treated as corpus donation. These amendments negate the case laws where in it

was held that donation received for construction of assets should be treated as corpus donation. In the case of *St. Anns Home for the Aged* v. *ITO* [1982] 13 TTJ (Bang.) 185, it has been held that the voluntary contributions expressly received for construction of a building were corpus donations, since they were received and utilized for a capital purpose.

2.06 ***Investing surplus fund or corpus donation in immovable property :*** It may be noted that an organisation may also create capital assets as an investment to be liquidated in future. Immovable property is also a permissible mode of investment under section 11(5) of the Income Tax Act, 1961. However, one should understand the difference between creation of asset for advancement of objectives and investment in capital assets as an investment to be liquidated in future.

2.07 ***Technical flaw of not amending section 12(1) :*** As per Section 12(1) any voluntary contribution not being towards corpus donation shall be deemed to the income derived from trust property held for charitable & religious purposes. It may be noted that under the existing law as well as the proposed law there are two sections where corpus donation can be claimed as exempt:

(i) The first option is to treat corpus donation as income under section 11(1) and then again treat it as an application under section 11(1)(d).

(ii) The second option is to directly treat corpus donation as exempt income under section 12(1).

There should have been correspoding amendment in section 12(1) also otherwise organisations will not include corpus donation in the income, at all, by applying section 12(1), which will negate the very purpose of these amendments.

APPLICATION OUT OF CORPUS FUND :

3.01 Any expenditure or application made out of the corpus 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.

3.02 ***Understanding the mechanism of claiming application made out of corpus or borrowed funds :*** It may be noted that organisations used to claim expenditure made out of corpus fund as well as borrower funds as application of current year income. After the amendments, the application (expenditure) towards charitable purposes shall be divided into three broad categories:

(i) Application (expenditure) made out of current year income.

(ii) Application (expenditure) made out of corpus or the unconditionally available funds of the organisation.

(iii) Application (expenditure) made out of loans and borrowings.

After enactment of Finance Bill 2021 no application other than application made out of income shall be allowed to be claimed in the Income and Expenditure Account. However, any expenditure made out of either corpus or borrowed fund can be claimed as application to the extent (i) new investment under section 11(5) is made, (ii) repayment of loan is made.

For example, an organisation has a total income of Rs. 1 lakh but spends Rs. 2 lakh during the year for charitable purposes. The source of the additional Rs. 1 lakh application is (i) Rs. 50,000/- from corpus fund lying in FDRs, (ii) Rs. 50,000/- from loan taken from bank. Under normal circumstances this additional Rs. 1 lakh expenditure would have resulted in a deficit of Rs. 1 lakh in the Income and Expenditure Account. After the current amendment, deficit of Rs. 1 lakh can never be claimed or set-off against future income but the organisation can create FDRs worth Rs. 50,000/- in future and can also repay Rs. 50,000/- in future years. Both will be treated as valid application in such future years.

APPLICATION OUT OF LOANS & BORROWINGS

4.01 Application from loans and borrowings shall not be considered as application for charitable or religious purposes for the purposes of third proviso to section 10(23C)

and clauses (a) and (b) of section 11(1). However, when loan or borrowings are repaid from the income of the previous year, such repayment shall be allowed as application in the previous year in which it is repaid to the extent of such repayment. Kindly also refer to the illustration under **para 3.02.**

TREATMENT OF SET-OFF OR DEDUCTION / ALLOWANCE OF EXCESS APPLICATION WHILE DETERMINING THE INCOME :

5.01 Set-off of past deficit against current years income will no longer be permissible for the purposes of computing 85% application.

5.02 ***Rationale behind not allowing set-off of deficit against current years income :*** Application for charitable religious purposes can be out of three sources :

(i) Current years income

(ii) Accumulated & Unconditional own funds (Corpus of the organisation)

(iii) Borrowed funds

In any year if there is a deficit i.e. excess of expenditure over income, it would imply that the organisation has over spent from either borrowed funds or its corpus. Such deficit, earlier, was allowed to be set-off against future income, but the Finance Bill 2021 proposes that effective from 1st April, 2021 corresponding to Assessment Year 2022-23, such deficit cannot be set-off against future income however investment as per section 11(5) to the extent of such deficit could be created. Kindly also refer to the illustration under **para 3.02.**

EDUCATIONAL AND MEDICAL INSTITUTIONS TOTALLY EXEMPT UPTO RS. 5 CRORE

6.01 The Finance Bill 2021 has made significant changes in sub-clauses (iiiad) & (iiiae) of clause (23C) of the section 10 and has provided that any educational or medical institution shall be exempt from Income Tax upto a total income (turnover) of Rs. 5 crore annually. This limit was only Rs. 1 crore prior to be amendment. This is a big take away for such institutions. It may be noted that under section 10(23C)(iiiad) &

(iiiae) an organisation is not required to get itself registered before any authority and is also not subject to 85% application. This amendment should immensely benefit small and medium educational or medical institutions. It also provides an insight into the Governments intent to encourage NPOs which are engaged in direct delivery activities such as education and medical relief.

REVISED AND BELATED RETURNS TO BE FILED BY 31ST OF DECEMBER EVERY YEAR

7.01 The last date of Belated or Revised Income Tax Returns has been preponed to 31st December. Earlier the last date of Belated or Revised Income Tax Returns was 31st March. As per the Proposed Amendment u/s 139(4) and (5), the last date for filing of belated or revised returns of income would be reduced by three months. Thus the belated return or revised return could now be filed three months before the end of the relevant assessment year or before the completion of the assessment, whichever is earlier. These amendments will take effect from 1st April, 2021 and will accordingly apply to the assessment year 2021-22 and subsequent assessment years.

Hence, all the NGO are now required to submit their return latest by 31st December w.e.f. AY 2021-22 in order to be eligible to claim the benefit of Section 11. This is a slightly harsh amendment in the light of the fact that the opportunity to file a Belated Return or a Revised Return has more or less been negated and an organisation will have no window to correct its mistakes or file a belated return after 31st December. However, this is a general amendment which applies to all assessees including NPOs.

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Published by **Dr. Sanjay Patra** on behalf of
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Annexure - 1

TEXT OF RELEVANT PROPOSED AMENDMENTS AS PER FINANCE BILL 2021

Amendment to section 10(23C)

(iii) in clause (23C),—

(I) in sub-clause (iiiad), for the words "receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed", the words "receipts of the person from such university or universities or educational institution or educational institutions do not exceed five crore rupees" shall be substituted;

(II) in sub-clause (iiiae),—

(A) for the words "receipts of such hospital or institution do not exceed the amount of annual receipts as may be prescribed; or", the words "receipts of the person from such hospital or hospitals or institution or institutions do not exceed five crore rupees." shall be substituted;

(B) after sub-clause (iiiae), the following Explanation shall be inserted, namely:—

"Explanation.—For the purposes of sub-clauses (iiiad) and (iiiae), it is hereby clarified that if the person has receipts from university or universities or educational institution or institutions as referred to in sub-clause (iiiad), as well as from hospital or hospitals or institution or institutions as referred to in sub-clause (iiiae), the exemptions under these clauses shall not apply, if the aggregate of annual receipts of the person from such university or universities or educational institution or institutions or hospital or hospitals or institution or institutions, exceed five crore rupees; or";

(III) in the third proviso,—

(A) the Explanation shall be numbered as Explanation 1 thereof and in Explanation 1 as so numbered, after the words "medical institution:" occurring

at the end, the words, brackets and figures "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) of section 11 maintained specifically for such corpus." shall be inserted;

(B) after Explanation 1 as so numbered, the following Explanation shall be inserted, namely:—

"Explanation 2.—For the purposes of determining the amount of application under this proviso,-

(i) application for charitable or religious purposes from the corpus as referred to in Explanation 1, shall not be treated as application of income for charitable or religious purposes:

Provided that the amount not so treated as application or part thereof, shall be treated as application for charitable or religious purposes in the previous year in which the amount, or part thereof, is invested or deposited back, into one or more of the forms or modes specified in sub-section (5) of section 11 maintained specifically for such corpus, from the income of that year and to the extent of such investment or deposit; and

(ii) application for charitable or religious purposes, from any loan or borrowing, shall not be treated as application of income for charitable or religious purposes:

Provided that the amount not so treated as application or part thereof, shall be treated as application for charitable or religious purposes in the previous year in which the loan or borrowing, or part thereof, is repaid from the income of that year and to the extent of such repayment:";

(IV) in the fourteenth proviso, after the figures and letters "12AA", the words, figures and letters "or section 12AB" shall be inserted;

(V) after the twentieth proviso, the Explanation shall be numbered as Explanation 1 thereof and after Explanation 1 as so numbered, the following Explanation shall be inserted, namely:—

"Explanation 2.—For the purposes of this clause, it is clarified that the calculation of income required to be applied or accumulated during the previous year shall be made without any set off or deduction or allowance of any excess application of any of the year preceding to the previous year;";

Amendment to section 11

6. In section 11 of the Income-tax Act, with effect from the 1st day of April, 2022,–

(a) in sub-section (1),—

(i) in clause (d), for the word "institution", the words, brackets and figures "institution, subject to the condition that such voluntary contributions are invested or deposited in one or more of the forms or modes specified in sub-section (5) maintained specifically for such corpus" shall be substituted;

(ii) after Explanation 3, the following Explanations shall be inserted, namely:–

"Explanation 4.—For the purposes of determining the amount of application under clause (a) or clause (b),—

(i) application for charitable or religious purposes from the corpus as referred to in clause (d) of this subsection, shall not be treated as application of income for charitable or religious purposes:

Provided that the amount not so treated as application, or part thereof, shall be treated as application for charitable or religious purposes in the previous year in which the amount, or part thereof, is invested or deposited back, into one or more of the forms or modes specified in sub-section (5) maintained specifically for such corpus, from the income of that year and to the extent of such investment or deposit; and

(ii) application for charitable or religious purposes, from any loan or borrowing, shall not be treated as application of income for charitable or religious purposes:

Provided that the amount not so treated as application, or part thereof, shall be treated as application for charitable or religious purposes in the previous year in which the loan or borrowing, or part thereof, is repaid from the income of that year and to the extent of such repayment.

Explanation 5.—For the purposes of this sub-section, it is hereby clarified that the calculation of income required to be applied or accumulated during the previous year shall be made without any set off or deduction or allowance of any excess application of any of the year preceding the previous year.";

(b) in sub-section (2), in the Explanation, after the figures and letters "12AA", the words, figures and letters "or section 12AB" shall be inserted;

(c) in sub-section (3), in clause (d), after the figures and letters "12AA", the words, figures and letters "or section 12AB" shall be inserted.