

TAXATION OF NPOs

U/S 115BBI

◆ Legal Series Vol. XVI ◆ Issue 4

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FAILURE TO COMPLY CONDITIONS OF APPLICATION OF INCOME



Standards & Norms

Resource support on NGO Governance, Accounting and Regulations



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INTRODUCTION AND OVERVIEW

1.01 Income derived from property held under trust or of an institution wholly for charitable/religious purposes is exempt if 85% of the income is spent on the objects of the trust during the year. As a matter of fact, charitable or religious institution are not subject to tax provided they follow all the conditions of registration as well as the compliance with regard to the application of income. Therefore, the tax liability is in the nature of a penalty against any violation of the provisions of the Act.

1.02 Income derived from property held under trust or an institution wholly for charitable/religious purposes is exempt if 85% of the income is spent on the objects of the trust during the year. If the amount spent is *less* than 85% of the income, the shortfall is taxable.

1.03 It is to be noted that Sections 11 to 13 are a complete code governing the taxation of charitable and religious institutions. It provides various situations that result in non-compliance and the implication for such non-compliance. In the event of non-compliance, such incomes shall not be subject to application and/or the benefit of section 11 and 12 will be withdrawn or the registration status will be lost for that particular year of non-compliance.

In this issue we shall discuss the provisions of section 115BBI which become applicable when an organisation fails to comply with the conditions under section 11 with regard to application of income.

OVERVIEW OF THE NON COMPLIANCES SUBJECT TO TAX

2.01 The provisions of section 14 and five heads of income do not apply to NGOs. Computation of income of NGO should be made only under sections 11 to 13, and

the other provisions of the Act are not applicable. As a matter of fact, in the case of a charitable or religious institutions, the income subject to tax is not computed. What is computed is the income eligible for exemptions under sections 11 and 12. This is the fundamental difference between a normal assessee and an exempt institution; therefore, the tax liability is in the nature of a penalty against any violation of the provisions of the Act.

2.02 Section 11(1)(a) makes it clear that the income derived from the property held under trust wholly for charitable and religious purposes, to the extent to which such income is applied to such purposes in India, is excluded. Once the income from property, as such, is excluded, there is no question of computing the income from the property by applying the provisions of section 14 and such income shall be subjected to tax under various specific provisions under sections 11 to 13.

2.03 It is to be noted that Sections 11 to 13 are a complete code governing the taxation of charitable and religious institutions. It provides various situations that result in non-compliance and the implication for such non-compliance. In the event of non-compliance, such incomes shall not be subject to application and/or the benefit of sections 11 and 12 will be withdrawn or the registration status will be lost for that particular year of non-compliance.

2.04 The following are the situations, the non-compliances of which shall be subject to penal tax:

- (a) Income applied outside India [Not covered under section 11(1)(c)]
- (b) Income under section 11(1B) where an organization fails to apply income after considering it deemed application by filing Form 9A.
- (c) Income under section 11(3), where an organization fails to apply income after accumulating it by filing Form 10.

- (d) Value of any Medical or Educational Services provided to Interested Persons [Section 12(2)]
- (e) Violation of conditions specified under section 12A(1)
 - (i) Non-filing of Income-tax Return
 - (ii) Non-obtaining & furnishing of Audit Report
 - (iii) Non-maintenance of books of account as prescribed under Rule 17AA (w.e.f. Assessment Year 2023-24)
 - (iv) Non-applying for renewal of Registration or for making the provisional Registration into a normal registration
- (f) Not applying for Re-registration for confirming the modification of the object clause
- (g) Violation of section 13(1)
 - (i) Income applied for the private religious purpose [Section 13(1)(a)]
 - (ii) Income applied for particular religious community or caste [Section 13(1)(b)]
 - (iii) Benefit to interested person [Section 13(1)(c)]
 - (iv) Investment of funds in an unspecified manner [Section 13(1)(d)].
- (h) Incidental business activity in excess of 20% of gross receipt [Section 13(8)]
- (i) Anonymous donations in excess of the exemption limit [Section 13(7)]
- (j) Shortfall in applying 85% of Income.

VARIOUS TYPES OF PENAL TAXATION OF NPOs

3.01 NPOs shall be subject to penal taxation for non compliances which are summarised in the following categories:

- (i) The income which is subject to tax due to specific non-compliances mentioned in section 115BBI shall be subject to tax @ 30%. (Inserted by the Finance Act, 2022 w.e.f. AY 2023-24)
- (ii) When benefits of Sections 11 and 12 are withdrawn for a specified reason, the income will be subject to tax as per section 13(10), read with section 164(2).
- (iv) When the registration is not renewed or the organisation fails to apply for renewal, the organization is subject to tax as a normal assessee, and income shall be computed under five heads of income as a normal assessee.
- (v) Anonymous donation under section 115BBC received by charitable organizations is taxable at 30% without any deduction or set-off under any other head.

INCOMES SUBJECT TO TAX UNDER SECTION 115BBI [FROM AY 2023-24]

4.01 *Hitherto*, there was no specific section for taxing the certain income of a charitable institution at a specific prescribed rate. The Finance Act, 2022 inserted a new Section 115BBI to provide a special rate of tax for the specified incomes of trust. Earlier, these incomes were subject to tax under Section 164(2). However, after Finance Act, 2022, these incomes shall be subject to tax @ 30% as per the newly inserted Section 115BBI effective from the Assessment year 2023-24.

4.02 Text of Section 115BBI

Specified income of certain institutions.

115BBI. (1) *Where the total income of an assessee, being a person in receipt of income on behalf of any fund or institution referred to in sub-clause (iv) or any trust*

or institution referred to in sub-clause (v) or any university or other educational institution referred to in sub-clause (vi) or any hospital or other medical institution referred to in sub-clause (via), of clause (23C) of section 10 or any trust or institution referred to in section 11, includes any income by way of any specified income, notwithstanding anything contained in any other provision of this Act, 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 such specified income; and*
- (ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the aggregate of specified income referred to in clause (i).*

(2) Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance or set off of any loss shall be allowed to the assessee under any provision of this Act in computing the specified income referred to in clause (i) of sub-section (1).

Explanation.—For the purposes of this section, “specified income” means—

- (a) income accumulated or set apart in excess of fifteen per cent of the income where such accumulation is not allowed under any specific provision of this Act; or*
- (b) deemed income referred to in Explanation 4 to the third proviso to clause (23C) of section 10, or sub-section (1B) or sub-section (3) of section 11; or*
- (c) any income, which is not exempt under clause (23C) of section 10 on account of violation of the provisions of clause (b) of the third proviso of clause (23C) of section 10, or not to be excluded from the total income under the provisions of clause (d) of sub-section (1) of section 13; or*

- (d) *any income which is deemed to be income under the twenty-first proviso to clause (23C) of section 10 or which is not excluded from the total income under clause (c) of sub-section (1) of section 13; or*
- (e) *any income which is not excluded from the total income under clause (c) of sub-section (1) of section 11.*

RATE OF TAX UNDER SECTION 115BBI

5.01 If the total income of any assessee being a trust referred under Section 11 or Section 10(23C), includes any income by way of any specified income, the income tax payable shall be the aggregate of:

- (a) the amount of income tax calculated at the rate of 30% on the aggregate of specified income; and
- (b) the amount of income tax the assessee would have been chargeable had the total income of the assessee would have been reduced by the aggregate of specified income referred to above.

5.02 It is important to note that, the tax rate shall be without the benefit of the basic exemption limit of Rs. 2.5 Lakhs. Also, before the insertion of Section 115BBI by the Finance Act, 2022, the specified incomes were subject to tax under Section 164(2). Therefore, most of the incomes were subject to tax with the benefit of an exemption limit of Rs. 2.5 Lakhs other than violations under Section 13(1)(c) and 13(1)(d).

NO DEDUCTION OF ANY EXPENSE OR LOSS

6.01 No deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any provision of the Act in computing the specified income [Section 115BBI(2)].

WHICH INSTITUTIONS ARE TAXABLE UNDER SECTION 115BBI?

7.01 The following institutions shall be covered for payment of tax under this provision:

- (a) Any other fund or institution established for charitable purposes [Section 10(23C)(iv)];
- (b) Any trust (including any other legal obligation) or institution wholly for public religious purposes or public religious and charitable purposes [Section 10(23C)(v)];
- (c) Any university or other educational institution existing solely for educational purposes (not for purposes of profit) [Section 10(23C)(vi)]; and
- (d) Any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes (not for purposes of profit) [Section 10(23C)(via)].
- (e) Any trust or institution, as referred to in Section 11.

INCOMES TAXABLE UNDER SECTION 115BBI

8.01 The Explanation to section 115BBI(2) provides a list of specified incomes that shall be taxable at a special rate of 30% under Section 115BBI. The following incomes of specified trusts and institutions shall be taxable under Section 115BBI.

- (a) **Shortfall in applying 85% of Income:** In order to be eligible for claiming exemption, it is essential that the income of the trust is applied to such objects. A charitable trust or institution will have to apply at least 85% of the income

to charitable purposes. Suppose the income spent on charitable or religious purposes, during the previous year, falls short of 85% of the income derived during the year. In that case, such shortfall will be liable to tax, and such income is liable to be taxed under section 115BBL.

If the trust has complied with the following conditions, it will not be subject to penal tax:

- (a) If an organization is not able to apply 85 per cent of its income in a particular year, then it can also accumulate the income in excess of 15 per cent of income. Such excess accumulation has to be used for religious or charitable purposes within the next 12 months or in the year of receipt of income under *Explanation* to section 11(1). Such accumulation is otherwise called deemed application.
- (b) Application in Form No. 10 to be made specifying the purpose for accumulation of income for a period of 5 years. Period for which the organization is unable to apply income for that purpose due to court order/injunction is to be excluded. The Finance Act 2023 has amended Section 11 to provide that Form 10 must be submitted at least two months before the due date of filing of income tax return specified in Section 139(1). Section 13(9) provides that to claim the benefit of accumulation for five years, Form 10 and ITR needs to be submitted before the due date. The Finance Act 2023 has amended Section 11(2) to prepone the date to file Form 10 by two months, however, no consequential amendment has been made in Section 13(9). So, in a way, it implies that there will be no penal consequences if Form 10 is filed up to the due date provided for filing an Income-tax return, i.e., there will be no withdrawal of exemption in respect of the accumulated amount.

(b) Deemed income referred to in Explanation 4 to the third proviso to section

10(23C): The Finance Act, 2022 inserted *Explanation 4* to the third proviso to Section 10(23C) to provide that any income referred to in the Explanation 3 shall be deemed to be the income of the previous year in which the following takes place:

- (a) the income is applied for purposes other than wholly and exclusively to the objects for which the trust or institution under the first regime is established or ceases to be accumulated or set apart for application thereto, or
- (b) the income ceases to remain invested or deposited in any of the forms or modes specified in sub-section (5) of section 11, or
- (c) the income is not utilized for the purpose for which it is so accumulated or set apart during the period referred to in clause (a) of *Explanation 3*.
- (d) the income is credited or paid to any trust or institution registered under section 12AA or section 12AB or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via).

For the circumstances referred to in clause (c), the income shall be deemed to be the income of the previous year which is the last previous year of the period, for which the income is accumulated or set apart under sub-clause (a) of clause (iii) of the proposed *Explanation 3*, but not utilized for the purpose for which it is so accumulated or set apart.

- (c) **Deemed income referred to in section 11(1B):** If an organization is not able to apply 85 per cent of its income in a particular year, then it can also accumulate income in excess of 15 per cent of income. Such excess accumulation has to be used for religious or charitable purposes within the next 12 months or in the year of receipt of income under Explanation to section 11(1). Such accumulation is otherwise called deemed application. Hence, NGOs can exercise the Option under clause (2) of the Explanation to sub-section (1) of section 11 by Filing Form 9A. The Finance Act 2023 has amended Section 11 to provide that Form 9A shall 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.

If any income in respect of which an option is exercised under clause (2) of the Explanation to sub-section (1) is not applied to charitable or religious purposes in India during the period referred to in sub-clause (a) or, as the case may be, sub-clause (b), of the said clause, then, such income shall be deemed to be the income of the person in receipt thereof and it shall be subject to tax under section 115BBI.

- (d) **Deemed income referred to in section 11(3):** If an organization is not able to apply 85 per cent of its income in a particular year, then it can exercise the option to accumulate the income in excess of 15 per cent of income for five years under section 11(2). The benefit of exemption, allowed to an assessee-trust for accumulation of its income in excess of 15% is subject to certain conditions and will be forfeited if such conditions are not complied with by the assessee. The amount of exemption allowed will be deemed to be the income of the assessee-trust.

Accordingly, where any trust income accumulated in excess of 15% and in respect of which exemption is granted, the exemption will be forfeited if:

- (a) It is applied for purposes other than religious or charitable or ceases to be accumulated or set apart for application to religious or charitable purposes;
- (b) It ceases to remain invested in statutory form of investment specified under section 11(5);
- (c) It is not utilized for the purpose for which it is so accumulated within the allowed period of 5 years or in the year immediately following the expiry thereof;
- (d) It is credited or paid to any other trust or institution registered under section 12AA/12AB;
- (e) It is credited or paid to any other fund, institution, trust, hospital, university or other educational institution, or hospital or any other medical institution referred under section 10(23C)(iv), (v), (vi) and (via).
- (f) Income is applied for private religious purposes or for the benefit of a particular religious community or a particular interested person which does not endure for the benefit of public as a whole.

If the exemption is forfeited due to above circumstances, the amount accumulated shall be deemed to be income of the previous year in which such default has occurred or at the end of the previous year or shall be taxed in the year in which the conditions of Section 11(2) are violated.

- (e) **Violation of provision relating to permissible investments:** The following incomes shall be taxed under Section 115BBI, i.e., any income which is not:

- (a) exempt under section 10(23C) on account of violation of clause (b) of the *third proviso* to section 10(23C); or
- (b) excluded from total income under section 13(1)(d).

The income of trust for charitable or religious purposes or a charitable or religious institution to be invested in permissible modes of investments under section 11(5). This violation shall attract that portion of income to be taxed under Section 115BBI.

The Finance Act 2022 has amended Section 13(1)(d) with effect from the assessment year 2023-24 to provide that in case any funds of the charitable institution are invested or deposited in any impermissible modes, then income to the extent of such deposits or investments shall not be excluded from the total income of the institution. Thus, if an assessee makes an impermissible investment, the income equivalent to such investment will be subject to tax under section 13(1)(d). The part of income which is subject to tax as per the amended section 13(1)(d) shall be subject to tax @ 30% in terms of the provision of Section 115BBI.

[See *also*, the chapter on the Forfeiture – Violation regarding the investment of funds under section 13(1)(d)]

- (f) ***Income applied for the benefit of interested person:*** - The following income shall be subject to Section 115BBI, any income which is
 - (a) deemed to be income under the *twenty-first proviso* to section 10(23C); or
 - (b) not excluded from total income under section 13(1)(c).

If the income or part of income or property of any trust or institution has been applied directly or indirectly for the benefit of any person referred to in Section 13(3), such income or part of income or property shall be deemed to be the income of such person of the previous year in which it is so applied. Such income shall be subject to tax under Section 115BBL.

Section 13(1)(c) is attracted if the income of a voluntary organization is applied for the benefit of certain specified interested persons. The Finance Act, 2022 has amended Section 13(1)(c) to provide that only that part of income which has been applied in violation to the provisions of the said clause shall be liable to be included in total income. This part of income which is subject to tax as per the amended section 13(1)(c) shall be subject to tax @ 30% in terms of the provision of Section 115BBL.

In addition to this, part of the income shall also be subject to penalty under newly inserted Section 271AAE w.e.f. Assessment Year 2023-24. The Finance Act, 2022 has inserted a new section 271AAE which provides for penalty, if benefit is provided to specified person in violation of section 13(1)(c).

- (g) ***Application towards charitable purposes outside India:*** Under section 11(1)(c), income applied on activities outside India is not eligible for exemption unless the following conditions are satisfied:
- (a) The charitable organization happens to be a trust created before 1-4-1952 or it is engaged in promotion of international welfare in which India is interested,
 - (b) Central Board of Direct Taxes (CBDT) has by general or special order granted the exemption for carrying out such activities.

An organization can apply to the CBDT for permission to work outside India. The applications seeking approval u/s 11(1)(c) may be submitted in the office of Member (IT), Central Board of Direct Taxes, Department of Revenue, Ministry of Finance, North Block, New Delhi.

It may be noted that if the income is disallowed then the impugned amount shall be taxed under Section 115BBI. Thus, if a trust applies its income outside India without approval/permission from CBDT, then such income shall not be eligible for exemption and shall be subject to tax under section 115BBI.

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