

BUDGET 2026

◆ Legal Series Vol. XVIII ◆ Issue 9

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Standards & Norms

Resource support on NGO Governance, Accounting and Regulations

STRUCTURAL CHANGES IN TAXATION OF NPOs



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CONTENTS

1.	Introduction	01
2.	Merger of registered NPOs will not trigger the Accreted Tax	01
3.	No cancellation merely on carrying on commercial activity in the GPU Category	02
4.	Registered NPOs can file a belated return	04
5.	The time limit for filing a revised return is extended to 12 months	05
6.	Conclusion	06

INTRODUCTION

- 1.01** The Income-tax Act, 2025 introduced certain structural shifts in the charitable framework, which inadvertently created compliance risks and interpretational challenges for Non-Profit Organisations. The Finance Bill, 2026 marks the first legislative effort to correct these unintended consequences before the new law comes into force. This article analyses the key amendments affecting mergers, cancellation risks, return filing, registration requirements and compliance timelines for NPOs, and explains how these changes restore parity with the settled position under the Income-tax Act, 1961.
- 1.02** The Income-tax Act, 2025 (ITA 2025), though enacted with the objective of simplification and structural clarity, introduced certain unintended consequences for the Non-Profit Organisation (NPO) sector when compared with the settled framework under the Income-tax Act, 1961 (ITA 1961). Many provisions relating to registration, cancellation, merger, return filing, and exemption conditions were either drafted differently or positioned in a manner that created new compliance risks and litigation exposure for genuine NPOs.
- 1.03** The Finance Bill, 2026, now demonstrates the first legislative response to those concerns. A careful reading of the amendments shows that several provisions affecting NPOs have been revisited to restore parity with the legal position that existed under the ITA 1961 and to remove unintended hardship that would otherwise have arisen under the new regime.

MERGER OF REGISTERED NPOs WILL

NOT TRIGGER THE ACCRETED TAX

- 2.01** A new Section 354A is proposed to be inserted in ITA 2025, which provides that tax on accreted income under section 352 shall not apply where a registered

NPO merges with another registered NPO having the same or similar objects, subject to prescribed conditions. The amendment provides the statutory protection similar to Section 12ACf of the ITA 1961. This removes litigation risk in genuine NPO mergers.

- 2.02** *Clarificatory amendment in Table to section 352:* Along with the insertion of section 354A, a consequential clarification has also been carried out in Table Sl.No. 8 under section 352, applicable from tax year 2026-27. The earlier drafting of the table created ambiguity regarding the exact circumstances in which a merger would trigger tax on accreted income.
- 2.03** The amended table now clearly provides that accreted tax shall arise where a registered NPO merges with:
- (a) an entity other than a registered NPO; or
 - (b) a registered NPO having similar objects but the merger does not fulfil the prescribed conditions; or
 - (c) a registered NPO not having the same or similar objects.
- 2.04** When read together with the newly inserted section 354A, the legislative scheme now makes it unambiguously clear when accreted tax shall apply and it shall not apply in case of NPO mergers.

NO CANCELLATION MERELY ON CARRYING ON COMMERCIAL ACTIVITY IN THE GPU CATEGORY

- 301** Section 346 of the ITA 2025 prescribes specific restrictions on commercial activities undertaken by registered NPOs in the “advancement of any other object of general public utility” (GPU) category. Commercial activity is permitted only where all the following conditions are cumulatively satisfied:

- (a) The activity is undertaken in the course of the actual carrying out of the GPU object,
- (b) Aggregate receipts from such activity do not exceed 20% of the total receipts of the NPO for the relevant tax year, and
- (c) Separate books of account are maintained in respect of such activity.

3.02 This provision substantially corresponds to the proviso to Section 2(15) of the ITA 1961.

3.03 A breach of any of the conditions under Section 346, such as exceeding the 20% threshold, undertaking unrelated commercial activity, or failure to maintain separate books, attracts dual statutory consequences:

- (a) Section 351(1)(b) expressly includes a violation of provisions referred to in section 346 within the scope of “specified violations”. This empowers the tax authorities to cancel the NPO’s registration and may also result in tax on accreted income under Section 352, subject to the prescribed conditions.
- (b) Section 353 treats violation of Section 346 as an “other violation”, triggering a special computation mechanism under which certain exemptions are restricted, and income may be subjected to tax based on such computation.

3.04 Thus, a breach of section 346 was uniquely placed in two separate consequence categories; it was treated both as a “specified violation” under Section 351 and as an “other violation” under Section 353.

3.05 The Finance Bill 2026 proposes to remove commercial activity by NPOs under the “general public utility” category from the scope of “specified violation” under Section 351. Earlier, such a breach could have led to cancellation of

registration and levy of the exit tax. The amendment restores the position under the ITA 1961, where such violations result only in a year-specific denial of exemption. It shall now be treated merely as an “other violation” under Section 353, triggering special computation for that tax year without affecting the registration of the NPO.

REGISTERED NPOS CAN FILE A BELATED RETURN

- 4.01** Section 349 of the ITA 2025 mandates that where the total income of a registered NPO, computed without giving effect to the provisions of Chapter XVII-B, exceeds the maximum amount not chargeable to tax for any tax year, such organisation shall furnish its return of income in accordance with Section 263(1)(a)(iii) and (2), within the due date prescribed under Section 263(1)(c). This provision substantially corresponds to Section 12A(1)(ba) of the ITA 1961. Under the 1961 Act, entities registered under section 12AB were required to file a return of income under section 139(4A) where their total income, before giving effect to Sections 11 and 12, exceeded the basic exemption limit. Importantly, the statutory framework under the 1961 Act permitted such returns to be filed either within the due date under section 139(1) or as a belated return under section 139(4). In contrast, the 2025 Act does not recognise the concept of a belated return for a registered NPO. Exemption under the special NPO regime is available only where the return is furnished within the original due date specified under Section 263(1)(c). There is no reference to Section 263(4), which otherwise permits belated filing of returns within the extended statutory timeline.
- 4.02** The absence of reference to Section 263(4) had the legal effect that a delay in filing the return would trigger Section 353, resulting in special computation provisions for that year.

- 4.03** The Finance Bill 2026 proposes to amend Section 349 to insert a reference to Section 263(4), allowing registered NPOs to file a belated return and still claim exemption. This amendment aligns the ITA 2025 with the ITA 1961 position.
- 4.04** Accordingly, where the return is furnished within the time limit permitted for filing an original or belated return, it shall not be treated as an “other violation” under Section 353.

THE TIME LIMIT FOR FILING A REVISED RETURN IS EXTENDED TO 12 MONTHS

- 5.01** For NPOs, from assessment year 2026-27 and tax year 2026-27, the ability to correct omissions or errors in returns is crucial, as defects in return filing can directly jeopardise exemption claims under the charitable regime. The time limit for filing a revised return has now been extended.
- 5.02** Under the existing provisions of Section 263(5) of the ITA 2025 (corresponding to Section 139(5) of the ITA 1961), a revised return can be furnished within nine months from the end of the relevant tax year (i.e., up to 31 December of the assessment year) or before completion of assessment, whichever is earlier. Since the time limit for filing a belated return is also nine months, a taxpayer filing a belated return at the end of the permitted period is left with no opportunity to revise the return.
- 5.03** To address this issue, it is proposed to extend the time limit for filing a revised return from nine months to twelve months from the end of the relevant tax year or before completion of assessment, whichever is earlier. This effectively allows the revised return to be filed up to twelve months from the end of the relevant tax year (i.e., up to 31 March of the assessment year).

- 5.04** This extension will allow taxpayers to revise their returns even if a belated return was filed at the end of the permissible period. It is further proposed to levy a fee under Section 428(b) of the ITA 2025 [corresponding to Section 234F(1) of the ITA 1961] where a revised return is filed beyond nine months from the end of the relevant tax year. The fee shall be:
- (a) Rs. 1,000, where the total income does not exceed Rs. 5 lakh; and
 - (b) Rs. 5,000, in other cases.
- 5.05** Corresponding amendments are also proposed to Section 139(5) of the ITA 1961, introducing a new Section 263(5) to levy a similar fee for the delayed filing of revised returns. Accordingly, the extended timeline and fee provisions shall apply for the:
- (a) Previous year 2025-26 (assessment year 2026-27) under the ITA 1961; and
 - (b) Tax year 2026-27 onwards under the ITA 2025.
- 5.06** The Memorandum explaining the provisions of the Finance Bill, 2026 clarifies that the corresponding amendments in the Income-tax Act, 1961 shall come into force from 1 March 2026 and shall apply for assessment year 2026-27 (previous year 2025-26).

CONCLUSION

- 6.01** Budget 2026 represents the first substantive legislative refinement of the NPO framework under the ITA 2025, even before the new law comes into force. The amendments discussed above are not routine changes; they are structural corrections addressing unintended consequences arising from the redrafting of the charitable regime in the new Act.
- 6.02** Several provisions that, in their original form, exposed genuine NPOs to the risks of cancellation, exit tax, loss of exemption, and unnecessary compliance

burdens have now been realigned with the settled legal position under the ITA 1961. The insertion of positive protections, removal of dual consequences, restoration of belated return benefits, rationalisation of registration requirements, and extension of compliance timelines collectively indicate a legislative recognition of practical difficulties faced by the sector.

6.03 At the same time, these amendments also demonstrate that the transition from the 1961 Act to the 2025 Act is still an evolving process. While important corrections have been made, certain foundational and interpretational aspects of the NPO framework may still require further legislative clarification or administrative guidance before 1 April 2026.

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Published by **Sandeep Sharma** on behalf of
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