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Volume XXII, Issue-1, Jan-Jun, 2022

Financial Management Service Foundation
Promoting Accountability
fmsf

Summary of Key Amendments in Finance Act, 2022

Maintenance of Books of Accounts for NPOs

Understanding Board Processes

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Editorial Team: Dr. Sanjay Patra, Mr. Sandeep Sharma & Mr. Anil Kumar Baranwal
Published by Dr. Sanjay Patra on behalf of
Financial Management Service Foundation
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The Emperor's Seed

There was once an Emperor who had no children and needed to choose a successor. Thousands of children from across the kingdom came to the palace and were surprised when the Emperor exclaimed that he was going to choose one of them. He gave them all a seed. They were to go home to their villages, plant the seed in a pot and tend it for a year. When they return in a year, the Emperor would judge their efforts and choose his successor.

There was a boy named Ling who received his seed and returned to his village. His mother helped him to choose a pot and put some soil into it. Ling watered his pot every day. Once a week, the children of the village would get together to compare their plants. After a few weeks, there were signs of life in all but Ling's pot. The weeks passed and Ling continued to water his pot every day. After a few months, the pots really came to life. Some had trees starting to grow, some had flowers and some had leafy shrubs. Poor Ling still had nothing growing in his pot, leading the other children to make fun of him.

Ling continued to water his pot every day. A year passed and it was time to return to the palace to show what had grown and decide on the new heir. Ling was anxious as his pot still showed no signs of life. "What if they punish me? They won't know that I've watered it every day, they'll think that I'm lazy." His mother looked him in the eye and explained that whatever the consequences were, he had to return and show the Emperor his barren pot.

Ling and the other children entered the palace gates. By now, some of the plants were looking magnificent and the children were wondering which one the Emperor would choose. Ling was embarrassed as other children looked at his lifeless pot and scoffed.

The Emperor came out and started to make his way through the crowd, looking at the many impressive trees, shrubs and flowers that were on display. The boys all puffed their chests out and tried to look as regal as possible, hoping that they would be chosen as the heir to the empire.

Then the Emperor came to Ling. He looked at the pot then he looked at Ling. "What happened here?" He asked. "I watered the pot every day, but nothing ever grew." Ling muttered nervously. Then he moved on. After a few hours, the Emperor finally finished his assessment looking at wonderful grown plants.

He stood in front of the children and congratulated them on their efforts. "Clearly, some of you desperately want to be Emperor and would do anything to make that happen, but there is one boy that I would like to point out as he has come to me with nothing. Ling, come here please." "Oh no," thought Ling. He slowly sauntered to the front of the group, holding his barren pot.

The Emperor held up the pot for all to see and the other children laughed. Then the Emperor continued, "A year ago, I gave you all a seed. I told you to go away, plant the seed and return with your plant. The seeds that I gave you all were boiled until they were no longer viable and wouldn't grow, but I see before me thousands of plants and only one barren pot. Integrity and courage are more important values for leadership than proud displays, so Ling, he will be my heir."

Acknowledgment

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

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- Editorial Team

TABLE OF CONTENTS

Summary of Key Amendments in Finance Act, 2022

Introduction

The Finance Act, 2022 has brought in many path breaking changes for charitable and religious organisations. In this chapter, we are discussing in brief the various changes made through key amendments in the Income Tax Act.

Extensive Powers of Cancellation of Registration to AO and CIT

There have been important changes pertaining to extensive powers of Cancellation of Registration under section 12AB and Approval under section 10(23C). Earlier the Commissioner of Income Tax had relatively limited powers of cancellation under section 12AB(4) & (5), however, the Finance Act, 2022 inserted various specific violation and circumstances which may result in cancellation of registration.

The Commissioner of Income Tax have extensive power to cancel registration against various specified violation. The specified violations are as under:

- Income applied for purpose other than objects.
- Income from Non-Incidental Business.
- Separate books of Accounts not maintained for Incidental Business.
- Applied income for benefit of any particular religious community or caste.
- Activities carried on are not genuine.
- Activities are not according to the registration conditions.
- Non-compliance with other laws.

The circumstances under which a cancellation proceeding can be initiated are as under:

- PCIT/ PC noticed occurrence of one or more 'Specified Violations' during any previous year.
- Reference from the Assessing Officer under the second proviso to Section 143(3).
- Case has been selected in accordance with the risk management strategy of CBDT.

The above amendments are highly arbitrary and debatable particularly with regard to :

(i) The power of the Assessing Officer to refer an organisation to the CIT even before completion of assessment. In other words, the CIT can initiate proceeding and cancel the registration

even before the AO has completed assessment under section 143(3) only based on the pre-assessment information provided by the AO. An extreme step of cancellation being initiated without any evidence or conclusive reason is highly arbitrary and needs reconsideration.

(ii) The power of the CBDT to initiate cancellation proceeding based on its strategy for risk mitigation. In other words, CBDT based on artificial intelligence or any other model of selection may initiate cancellation proceedings. An extreme step of cancellation being initiated through sampling or artificial tool without any evidence or conclusive reason would tantamount to a *'roving inquiry based cancellation proceeding'* and therefore is highly arbitrary and needs reconsideration.

Additional Condition under Section 10(23C) Bringing it Closer to Section 12AB Registration

The Finance Act, 2022 has added various new conditions to organisations having approval under section 10(23C)(iv), (v), (vi) & (via) which effectively takes away all the advantages enjoyed by such organisations over organisations registered under section 12AB. The new conditions applicable to such organisations are briefly provided as under:

- Requirement of furnishing Income Tax Return as a condition.
- Requirement of uploading of Audit Report.
- Restrictions on payment to specified persons.
- 5 years Accumulation provisions in line with Section 11(2).
- Accreted tax under Section 115TD.

The above additional conditions virtually leave approvals under section 10(23C)(iv), (v), (vi) & (via) with no edge or advantage over organisations registered under section 12AB. However, there are few differences between these two category of institutions which still remain and are as under:

- Organisations registered under section 12AB cannot make any application of income outside India under section 11(1)(c), there is no such condition for organisations approved under section 10(23C)(iv), (v), (vi) & (via). It may be noted that even in the absence of any such condition, organisations approved under section 10(23C)(iv), (v), (vi) & (via) are required to predominantly work in India only.
- Organisations registered under section 12AB have the option under Form 9A to spend in subsequent year if the income is not received during the year or is received towards the end of the year under Explanation to section 11(1). However, no such option is available to organisations approved under section 10(23C)(iv), (v), (vi) & (via).

- The most important benefit which a 12AA registered organisation enjoys is retrospective exemption under second proviso to Section 12A(2).

Barring the above conditions and benefits, there are no other differences between an organisation registered under section 12AB and organisation approved under section 10(23C)(iv), (v), (vi) & (via). In our opinion, the retrospective tax benefit under second proviso to Section 12A(2) would make organisations registered under section 12AA a more preferred option, now onwards.

Section 115BBI Inserted to Tax the Income of NGOs at Maximum Marginal Rate

The Finance Act, 2022 has inserted a new section 115BBI to tax the following income of charitable organisations at 30% tax rate:

- If accumulation is made in excess of 15% of total income without filing Form 9A or Form 10 then such excess accumulation.

- If any income accumulated to subsequent year or five years by filing Form 9A or Form 10 is not applied within the prescribed time frame.

- Any income which is subject to tax as a violation under section 13(1)(c) which is for providing unreasonable benefit to specified person.

- Any income which is subject to tax as a violation under section 13(1)(d).

- Any income which is subject to tax as a violation under section 11(1)(c).

The above amendments raise the following issues/questions:

(i) Under section 13(9), if an organisation fails to file Income Tax returns and Form 10 in the prescribed time then the income so accumulated become taxable, any income determined under section 13(9) will be taxable under section 115BBI.

(ii) Section 115BBI does not mention income subject to tax due to application of section 11(4A) i.e. violation of conditions for incidental business.

(iii) Section 115BBI does not mention income subject to tax due to application of proviso to section 2(15) read with section 13(8) i.e. violation of conditions for incidental business.

(iv) Section 115BBI does not mention income subject to tax due to application of proviso to section 13(1)(b) i.e. forfeiture of exemption for applying income for the benefit of a particular religious community.

New Section to Tax the Income for Violations under Section 12A and Section 13(8)

The Finance Act, 2022 has inserted a new section 13(10) to tax the income of an organisation for violations of section 13(8) and certain provisions section 12A. It may be noted that under this section the normal tax rates shall apply, further this taxation

pertains to basically to those institutions where the benefit of section 11 is totally denied but the 12AB registration is not yet cancelled. This newly inserted section shall be applicable for following violations:

- Having commercial receipts in excess of 20% of the annual receipts in violation of the provisions of proviso to section 2(15).
- Not maintaining the books of accounts and records as prescribed.
- Not getting the books of account audited.
- Not filing the return of income.

The income chargeable to tax shall be computed after allowing the deduction for the expenditure (other than capital expenditure) incurred in India for the objects. Subject to fulfilment of the following conditions:

- Expenditure is not from the corpus.
- Expenditure is not from any loan or borrowing.
- Claim of depreciation is not in respect of an asset which has been claimed as an application of income.
- Expenditure is not in the form of any contribution or donation to any person.
- Disallowances for cash payment and Non TDS shall apply.
- No set off of earlier year loss.

Maintenance of Books of Accounts as an Additional Condition of Registration

The Finance Act, 2022 has inserted a new clause/ condition under section 12A(1) which makes it mandatory to maintain books of account in such form and manner as may be prescribed. It may be noted that maintenance of books of accounts was an implicit condition because of the Audit requirements but the amendment has made it explicit.

We need to wait for the Rules providing for form, manner & the place.

Section 13(10) has been inserted for computing income chargeable to tax, if books of accounts as provided are not maintained.

Similar amendment are under section 10(23C).

Cash Basis of Accounting Compulsory for Application of Income

The Finance Act, 2022 has inserted a new explanation to section 11 just after sub section 7 which provides that all expenditure under section 11(1a) should be admissible on cash basis. In other words, accrual basis of accounting will no longer be permissible for application of income.

It is amended that the amount of application shall be considered only if it is actually paid -

i) Irrespective of the year in which liability arises; and

ii) Irrespective of the method of accounting regularly employed.

The change has settled the controversy as how the amount applied for shall be determined but:

- There will be an accounting challenge to determine the application amount on cash basis where accounts are maintained on accrual basis (Section 8 company);

- In certain cases, it will go against the TDS provisions which are also applicable to NGO. Similar amendment are under section 10(23C).

Voluntary Contributions to Notified Religious Institutions

The Finance Act, 2022 has provided that Voluntary Contributions for the renovation and repair of Religious places notified under clause (b) of sub-section (2) of section 80G can be treated as corpus donation even without in a specific direction from the donor. The key issues in this regard are as under:

- Normally, the benefit of Section 80G are not available to religious trust;

- In case of Religious cum charitable trust, 80G approvals are given only if the expenditure on religious purpose does not exceed 5% of income;

- Section 80G(2)(b) is a separate section enabling religious trust being a place of public worship throughout any State or States and notified as such by the Central Govt. can also apply & avail 80G benefit;

- The amendment has brought certainty on the treatment of the voluntary receipt under this approval of 80G & it provides - that the amount of voluntary contribution received can be treated as received towards corpus at the option of recipient NGO.

Conditions to be Fulfilled

- Corpus to be applied only for the purpose for which the voluntary contribution was made;

- Corpus shall not be applied for making a contribution or donation to any person;

- Corpus to be maintained as separately identifiable;

- Corpus to be invested in Section 11(5) modes.

Commercial Contracts under Amended FCRA, 2020

Overview of Commercial Contracts under FCRA

The Foreign Contribution (Regulation) Amendment Act, 2020 prohibits inter charity donations i.e. one FC registered organisation cannot sub-grant, further, to another FC registered organisation. This amendment has become effective from 29th September 2020.

The Concept of Mother NPO and Grassroots NPOs has been withdrawn, which implies that all NPOs receiving FC fund have to directly implement the project activities. Now onwards, large national level NPOs cannot provide funding support to smaller downstream organizations for implementation of project activities. As an alternative measure many NPOs and Donor agencies have been exploring the option of awarding commercial contracts for implementation of the project activities.

Awarding Commercial Contract for Implementation of Activity

It is being contemplated whether the lead partner can implement the programs by awarding service contracts to the implementing NPOs for the entire program or for monitoring purposes. However, it is not permissible to award service contracts for implementing the activities as per a budget. An NPO may award commercial contracts to vendors for rendering specific services or materials which are required for implementation of the program. Any out sourcing of the 'charitable activity' itself will be treated as a colourable device to evade the amended FCRA Law. Further, such activities shall have very high tax implications under Goods and Service Tax (GST) and will also be treated as commercial activity under Income Tax Law which will endanger the tax exempt charitable status of the NPO. The aforesaid shall not affect genuine activities against consideration for example renting of premises or taking a specific service against invoice etc. which will depend on the actual facts and circumstances.

It may be noted that it is not permissible to award a commercial contract for implementation of activity. The following legal provisions should be considered before awarding a commercial contract:

i) If the contract is for utilisation of entire fund as per mutually agreed activities, then such contract will be treated as charity contracts and FCRA law will apply. For commercial contract it is necessary to create Client - Service Provider Relationship which implies that the client must not only pay the expenses of the service but also the consideration or reward for the service to the service provider. It may be noted

that a charitable organisation cannot undertake commercial activities beyond 20% of its total receipts under section 2(15) of the Income Tax Act. In other words, even if some incidental services are undertaken on commercial terms the whole grant amount cannot be subjected to commercial contracts. Relevant case law: Apitco Ltd. v. Commissioner of Service Tax, Hyderaba [2012] 26 taxmann.com 213 (SC).

ii) The service provider should raise an invoice for specific deliverables and should not be accountable for actual utilisation of funds.

iii) If a charitable organisation is engaged as a vendor and if the activity contracted for is similar to its primary activity for charitable purposes, such activities shall remain as charitable activity under FCRA and Income Tax purposes, even if it is treated as a commercial activity under Goods and Service Tax Act. A charitable activity normally does not get converted into a commercial activity, if fees are charged or any surplus is generated. The Supreme Court in the case of *CST v. Sai Publication Fund* [2002] 258 ITR 70/122 Taxman 437 held that incidental business activity should not be treated as business at all. Even if an NGO had Sales Tax & Excise Registration and was defined as a commercial dealer under other law, it would not be treated as business activity for the purposes of Income-tax Act. The Hon'ble High Court of New Delhi in the case of ICAI Accounting Research Foundation v. Director General of Income-tax (Exemptions) [2009] 183 Taxman 462 (Delhi), held that a charitable activity would not become a commercial activity only because fees are charged or any surplus is generated. The High Court of Delhi in the case of Institute of Chartered Accountants of India v. Director General of Income-tax (Exemptions) [2013] 35 taxmann.com 140 held that where dominant objective was charitable in nature then conducting coaching classes and campus placements for a fee could not be held as business as per section 2(15).

iv) While awarding a commercial contract, it should be ensured that the vendor is otherwise providing similar services to various clients on commercial terms.

Foreign Donor Awarding Commercial Contract to Implement the Programs

It is being debated whether the foreign donors can award commercial contract to implement the programs. In our opinion, such arrangements are legally not permissible. After enactment of Foreign Exchange Management Act 1999 (FEMA) with effect from 1st June, 2000, a foreign donor can work and have activity in India only under the following circumstances:

- A foreign donor can work in India through organisations which have FCRA registration or prior permission by providing grants for approved and permissible projects.

- A foreign donor can also work in India through its branch office in India. However, it will have to get an approval from the Reserve Bank of India under FEMA.

There is no third option for a foreign donor agency to have activity in India. If an Indian organisation (whether NPO or commercial entity) enters into a commercial contract with a foreign donor agency to implement its (foreign agency's) activity in India, then it should ensure that such foreign donor agency has the right to conduct charitable activity in India, which is available only if a branch office approval from RBI is obtained.

Can an Indian NPO Import Services from FC Funds

An Indian FC registered organisation can import any kind of goods and services from foreign sources provided:

i) The FC registered organisation needs such services for implementation of its program, for example any medical equipment not available in India.

ii) The foreign service provider should actually deliver services in India against invoice.

iii) Any transfer to foreign service provider shall be subject to deduction of TDS.

Can the Lead Partner Use the Premises of the Implementing Partner on Rent

Legally, there is no bar if the premises of any former partner is taken on rent. However, any such arrangement should be supported by proper lease agreements and the title of the property should be with the implementing partner.

Legal Due Diligence for Donors after FCRA Amendments, 2020

Introduction

In this chapter, we discuss certain issues which need to be kept in mind at the Donor Agencies level. The donors who are funding partners in India should ensure the legal compliances mentioned in the further sections hereafter.

Administrative Expenditure

Section 8 of the FCRA, 2010 provides that the administrative expenditure shall not exceed 20% of the total utilisation of funds out of FCRA receipts. Further, it states that any expenditure of administrative nature in excess of 20% shall be defrayed with prior approval of the central government.

The definition of Administrative Expenditure briefly is as under:

- Remuneration and other expenditure to Board Members and Trustees.
- Remuneration and other expenditure to persons managing activity.
- Expenses at the office of the NGO such as Electricity, Water, Telephone, Postal, Stationery & Printing, etc.
- Cost of accounting and administration.
- Expenses towards running and equipment.
- Cost of writing and filing reports.
- Legal and professional charges.
- Rent and repairs to premises, expenses on other utilities.

The rule further provides that any type of expenditure expended directly on programme activities shall not be considered as administrative in nature.

Possible Caution/ Actions by Donors:

The program/ project budget should be structured properly in order to absorb the salary and other administrative components which can be directly attributed to the program.

Donor Agencies may ask for the overall budget of the organization and analyse the administrative cost component in the budget in line with the Rule 5 of FCRR, 2011.

Validity of The Registration Certificate

Section 11 of FCRA, 2010 has restricted the validity of FCRA registration to a period of 5 years from the date of its issue. All organisations registered on the date when FCRA, 2010 came into force, will have to

go for renewal after next 5 years.

As per Section 16 of the Act, all NGOs should apply for renewal of the certificate within 6 months prior to the expiry of the five-year period.

The organization failing to apply in time would have to face cancellation of registration and the FC funds and FC assets may go into the custody of competent authority.

Possible Caution/ Actions by Donors:

The Donor Agencies should ascertain the status of registration of the Organisation that they are funding or planning to fund and period for which it is valid.

In case the project is going beyond the expiry of registration, Donor Agencies should keep track of application for renewal.

It is advisable to synchronise the project period to end within original date of expiry of registration and start another project only in the following circumstances:

i) If the registration has been renewed for the next block of five years, or

ii) If the validity of original date of expiry of registration is extended for further period through a notification from MHA.

Consultancy Income of an NGO

FCRA, 2010 excludes 'the professional/ consultancy fees paid to NGOs from Foreign Source' from the definition of Foreign Contribution.

Explanation 3 to Section 2(1)(h) of FCRA, 2010 states that any amount received, by any person from any foreign source in India by way of fee or cost against business, trade or commerce shall not be considered as foreign contribution. In other words, such receipts shall be kept outside the FCRA account.

However, the provision is in contradiction with the amended section 2(15) of the Income Tax Act, 1961 which prohibits trade or business related receipts beyond 20% of total receipts. Therefore, NGOs should be careful in treating consultancy income and other receipts as local income even though it is permissible under the FCRA 2010.

Possible Caution/ Actions by Donors:

Payment of Consultancy Fees to NGOs by foreign Donor Agencies would not fall into the ambit of FCRA. If there is any element of help or support in such agreement then it will be treated as foreign contribution. For example - An unsecured loan for development programme will not be treated as commercial transaction. But a secured loan may be treated as commercial transaction.

Donors should avoid awarding grant type of contracts as commercial contracts to some partners and grant contracts to some other partners.

Requirement to Put Information in Public Domain

Rule 13 of FC(R)R, 2011 provides for requirement of keeping the audited statement of account on receipt and utilization of FC in public domain. The audited statement should include the following:

- Income and Expenditure Statement,
- Receipt and Payment Account,
- Balance Sheet.

The Rule provides that FC registered organisations should upload both quarterly and annual financial information through their website or government website.

The manner of disclosure or meaning of 'public domain' has not been specifically explained. It is understood that all such organisations are required to upload data on website.

Possible Caution/ Actions by Donors:

Donor Agencies may ask for website in the organizational profile and verify that the information, as required by the rule, is kept in the website and is accessible to all.

Donor Agencies may ask the NGOs they are funding or planning to fund but do not have a website, to create a website and put its accounts on it.

Inter-Organisational Transfer of FC Fund

Section 7 of FCRA provides that an organisation shall not transfer FC fund to another organisation irrespective of whether such other organisation is also registered under FCRA or not.

Possible Caution/ Actions by Donors:

The Foreign Donor Agencies should ensure that Nodal/ Principal Partner is not transferring FC fund to any other organisation and implementing the projects directly.

Power to Notify Sources From Which FC Can Be Accepted

The Act provides power to the Central Government under section 11(3) (iv) to notify such source(s) from which foreign contribution shall be accepted with prior permission only. It implies that the Central Govt. may notify specific donors or countries from which foreign funds could not be received or shall be received with prior permission only.

Possible Caution/ Actions by Donors:

The donor agency should make a detailed study as to the objectives of the organisation to be funded so that they don't land in to the list of restricted donors or donors who require prior permission from Central Government before funding.

Bank Account Related Issues

FCRA, 2010 and FCRR, 2011 specify that foreign contribution should be received in the designated bank account opened with State Bank of India, New Delhi Main Branch only. However, after receiving the funds in the designated bank account, the

organisation may transfer funds to other FC bank accounts earmarked to specific donors or projects for utilisation of the same.

The utilization bank account as mentioned above should also be intimated to MHA through form FC-6D within 15 days of opening of the utilisation bank account.

Possible Caution/ Aactions by Donors:

The donor agency should ensure that the funds are transferred only in the approved and designated bank account and subsequently the donor may ask the partner to open dedicated bank account for specific projects.

The donor agency should also ensure that the dedicated FC project bank account, if any, is intimated to the MHA.

Prohibition of Speculative Investment

The FCRA law does not permit investment of surplus funds in risky or speculative assets. Rule 4(1)(a) prohibits investment in shares & stocks even through mutual fund.

Rule 4(1)(b) prohibits investment in high return schemes like investment in chits or in land or similar assets, if it is not directly linked to the declared aims and objectives of organisation. Basically, the idea is to prevent investment of short term funds into risk bearing instruments or assets.

Possible Caution/ Actions by Donors:

The donor should ensure that the balance of project fund available with the partner is kept in FC bank account or invested in secured instruments. The donor should also ask for the details of investment against the available project balance at the end of each period.

Suspension of Registration Certificate

Section 13 of the Act allows the power to suspend the registration pending cancellation of certificate, for a period upto 360 days. During suspension the organisation cannot receive any foreign fund without prior approval. However, such organisation can utilise the existing foreign funds to the extent of 25%, with prior approval from FCRA wing of the Ministry of Home Affairs.

Possible Caution/ Actions by Donors:

The donor should seek a declaration from the partner that its certificate of registration has not been suspended. Special care is necessary in case of 'networks' because if the lead project holder's certificate is suspended, then the activity of the entire network may come to a halt.

Persons Specifically Debarred from Receiving Foreign Contribution

Section 3 of FCRA, 2010 specifies that the following persons cannot receive foreign contribution:

a) Candidate for election.

b) Correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper.

c) Public Servant, Judge, Government servant or employee of any corporation.

d) Member of any legislature.

e) Political party or office-bearer thereof.

f) Organisation of a political nature.

g) Association or company engaged in broadcast of audio or visual news.

h) Correspondent, columnist etc. related with the company referred in clause(g).

In this context, it is important to note that clause(g) above prohibits an organisation engaged in broadcast of audio or visual news.

Possible Caution/ Actions by Donors:

The donor should seek a declaration that the partner is not engaged in any broadcasting activity or dissemination of public news or current affairs. It may be noted that such activity is not permissible at all, whether from foreign or local funds. In this regard, a review of the website and social media presence of the partner is essential.

General Legal Compliances

Donors should seek a declaration that the partner is complying with the legal requirements such as:

- Filing of Annual returns under Income Tax Act and FCRA.
- Deducting tax at source in payments such as salary, consultancies, fees, rent, payment to contractor etc.
- Project funds are not used for the benefit of any board member or interested individual.
- Notional expenditure are not charged to project. Notional expenditure may include internal transfers or estimated expenses against services or assets used.

Understanding Sub-Grants under Amended FCRA, 2020

Overview of Sub Granting Under FCRA

The Foreign Contribution (Regulation) Amendment Act, 2020 prohibits inter charity donations i.e. one FC registered organisation cannot sub-grant, further, to another FC registered organisation. This amendment has become effective from 29th September, 2020.

The Concept of Mother NPO and Grassroots NPOs has been withdrawn, which implies that all NPOs receiving FC fund have to directly implement the project activities. Now onwards large national level NPOs cannot work with smaller downstream organizations.

This amendment is a deviation from the normally accepted norms of charitable activity. The Supreme Court and other Courts of India have in the past ruled that working through another organisation is at par with implementing direct activities. The Supreme Court in CIT v. Thanthi Trust [1999] 239 ITR 502, has also upheld the treatment of inter-charity donations as valid application of funds. This dictum will no longer apply to FC registered organizations sub granting out of FC fund.

The unspent project funds, as on 29th September 2020, collected on behalf of other organisations cannot be transferred to such organisations. After the amendment in the FCRA law, it is not permissible to pay or reimburse for any charitable activity undertaken by the partner prior to 29th September 2020.

Consortium contracts, where multiple Indian registered organisation partner together undertake a project, will no longer be permissible unless the partners are covering their costs with their own funds (Indian Funds). The donor has to work with only one Indian registered implementing partner at a time. However, there may be relationship with other partners or stake holders to the extent it does not involve transfer of FC fund directly or indirectly.

Statutory Changes Pertaining to Sub-Granting

The Foreign Contribution (Regulation) Amendment Act, 2020 has been enacted and notified effective from 29th September, 2020. This act has amended the Foreign Contribution (Regulation) Act, 2010 and has brought many radical changes having far reaching impact. The amended section 7 of the Act prohibits inter charity donations i.e. one FC registered organisation cannot sub-grant, further, to another FC registered organisation. We shall discuss the various immediate and long-term issues and challenges in this regard herewith. The text of the amended section 7 is as under:

"7. Prohibition to transfer foreign contribution to other person.

No person who-

a) is registered and granted a certificate or has obtained prior permission under this Act; and

b) receives any foreign contribution, shall transfer such foreign contribution to any other person."

It can be seen that foreign contribution can no longer be transferred to another organisation as was permissible earlier. The text of section 7 prior to amendment was as under:

"No person who -

a) is registered and granted a certificate or has obtained prior permission under this Act; and

b) receives any foreign contribution,

shall transfer such foreign contribution to any other person unless such other person is also registered and had been granted the certificate or obtained the prior permission under this Act:

Provided that such person may transfer, with the prior approval of the Central Government, a part of such foreign contribution to any other person who has not been granted a certificate or obtained permission under this Act in accordance with the rules made by the Central Government."

It can be seen that the sub-granting shall be permissible only with prior approval of the Central Government. There is no known precedence of any such approval being granted by the Central Government.

As Sub-Granting is Not Permissible, Can the Lead NPO Work Indirectly with the Implementing Organisation

It has to be understood that under the amended law, there is no concept of lead NPO and implementing NPO; all organisations have to be direct implementer as far as FC fund/ projects are concerned.

It can be seen that foreign contribution can no longer be transferred to another organisation as was permissible earlier. The FCRA law is very particular that there should not be any direct or indirect involvement of any other entity in utilisation of FC funds.

It may also be noted that the Foreign Contribution (Regulation) Amendment Rule, 2020 has amended Form FC - 4 and this amended form requires a declaration on 15 specific points which also includes direct or indirect transaction or activity with any FC or Non-FC registered organisation. The three relevant declaration in this regard are re-produced as under:

(i)	any foreign contribution was transferred to any FCRA registered association?	Yes No
(ii)	any foreign contribution was transferred to any Non FCRA registered association?	Yes No

(iii) any organization/entity not belonging to the Association is being managed/financially supported by the Association? Yes No

In the light of the above three clauses, particularly clause (xiv), it is important that there is no direct or indirect relationship with the implementing FC registered partner for that matter and any other charitable organisation whether registered under FCRA or not. Further, it is not advisable to hire any erstwhile implementing partner as a vendor or service provider for any program component, unless such organisation is actually providing such services in the normal course of its functioning.

Further, if it is proposed to hire the staff of the implementing organisation then any such recruitment should be an independent process i.e. anybody working anywhere shall have the opportunity to be recruited subject to eligibility criteria. In other words, such independent partner should terminate and settle the employment contract of all the employees being recruited by the lead NGO. The lead NGO may employ all or some of those staff with independent employment contracts through a normal recruitment process.

Can the Lead Partner Draw a Consultancy Contract with the Staff of the Implementing Organisation

In our opinion, it is not advisable to use fulltime employees of other organisations as contractors. However, the following issues are relevant in this regard:

- A consultant cannot be hired to implement the primary activities of an organisation, a consultant can be hired to deliver specific goods or services in the course of implementation of the program. For example, a doctor cannot hire another person to carry out diagnosis or treatment on its behalf, it can hire the services of a nurse, pathologist, attendant, medicines supplier, etc.

- When a consultant is hired to implement a charitable project then such consultant would not be giving any services back to the contractee, he/she would be delivering the service on behalf of the NGO to the beneficiaries or the community. Therefore, the consultant will be in the nature of an intermediary or a trustee for implementation of a charitable project. The only difference will be that such consultant is working on commercial terms. It has been held that a charitable activity does not get converted into a commercial activity only due to existence of profit.

Further, if the idea is to hire consultants who would work like the staff of the organisation, then in our understanding there is a fundamental difference between a consultancy contract and an employment contract. To establish a contract to be in the nature of a consultancy contract, the following conditions should be fulfilled:

- A consultancy contract should be based on deliverables. The consultant should be bound by the deliverables and not working days/hours.

- An invoice should be raised by the consultant.

- A consultancy contract should not be based on working hours at a particular place of work (it could include travel and work from home).

- A consultant should not report to the employer; he should only be liable for the deliverables and other terms of the contract.

In the light of the above whether a contract should be in the nature of consultancy or employment, may be determined.

In the light of the above, the lead agency may implement the project directly by hiring employees. It should avoid consultancy contract unless such contracts are for specific service or deliverable.

An NPO may award commercial contracts to vendors for rendering various services or materials which are required for implementation of the program. Any outsourcing of the 'Charitable activity' itself may be treated as a colourable device to evade the amended FCRA Law.

Can the Lead Partner Hire the Staff of Implementing Organisation as Volunteers

As discussed earlier, a person working as a whole time employee in another organisation should not be considered for execution responsibility. An organisation may have staff and volunteers only in the normal course of its functioning. Using the staff or functionaries of another FC registered organisation is not advisable under the current FCRA law.

Can the Donor Make Tripartite Agreement and Transfer Funds Directly to All Partners

Such an option is technically possible but generally not feasible for most of the donors as the cost and the monitoring responsibility increases many fold, if the donor works with various small partners by directly transferring funds each of such partners. In our opinion, a tripartite agreement (one project split into several contracts) is not advisable unless all the parties, except the donor, are direct implementers. If there is a mother agency engaged in say, monitoring work then;

i) the entire budget at the end of the mother NGO will be treated as admin expenses.

ii) the implementing partner may be perceived as an organisation managed by the mother NGO, in the light of the declaration No. (xiv) under Form FC - 4.

Is it Permissible to Contribute Funds/ Equipment to SHG, Panchayat or Local Committee

An NPO cannot make a payment from foreign contribution or give ownership of the assets created by utilising foreign contribution to SHG, Panchayat or Local Committee for development of local school, medical, etc. after the amendments introduced by the Foreign Contribution (Regulation) Amendment Act, 2020.

Self Help Groups (SHGs) are an association of persons, facilitating the implementation of development activities in the communities at the grassroots, the same is true for Panchayats and Local Committees; they cannot be treated as individual beneficiaries. Any amount of assets transferred to them will be utilized for the benefits of the beneficiaries or their members.

We have to understand that transferring fund to a member of SHG is different from transferring fund to the SHG, the former is permissible but transferring to SHG on behalf of members is technically not permissible. These associations/ entities will be treated as intermediaries. Therefore, such transfer of amount/ assets is not permissible.

The Section 7 of the Foreign Contribution (Regulation) Amendment Act, 2020 prohibits the transfer of Foreign Contribution from one registered organisation to another registered/ unregistered organisation. In other words, the organisation can itself utilise the foreign contribution towards the objective of the economic, educational, religious, cultural, or social program, as approved in the FCRA registration certificate, but cannot make a sub-grant out of it.

If an NPO intends to work with the SHG/ Local Committee by creating an asset, then such NPO should retain the ownership of the asset and can give right of managing or facilitation to the SHG/ Local Committee for the beneficiaries.

Is it Permissible to Contribute to an Individual Member of SHG, Panchayat or Local Committee

The ownership of the assets can be transferred to a particular member of LC/ SHG provided such member of the LC/ SHG is individual and is the end user or beneficiary. It is to be understood that the members are distinct from the LC/ SHG. An NPO can give assets only to individual members provided such members are eligible as beneficiaries.

If the asset is transferred to an individual who is a part of SHG or a member of LC, the ownership shall vest with the individual. In case the member leaves the LC/ SHG, the asset will continue to vest with the member being the legal holder of the asset. The LC/ SHG will have no right on such assets. As discussed above FC or FC Asset cannot be transferred to the LC or the SHG as they are not the end user or beneficiaries of the assets. However, FC or FC asset can be transferred to an individual for the end use for self-consumption.

Having said that, any grant made to individual beneficiaries is subject to due diligence with respect to selection of beneficiaries and the nature of the grant. There should be a systematic criterion to establish the eligibility and selection of the beneficiary and the amount or the nature of asset which could be given to each beneficiary should be reasonable and justified.

Under FCRA Rules, Can We Recognise an SHG or Local Committee as Equivalent to an Individual

SHG is an association of a person and not an individual. Usually, the members of SHG are individuals. From a legal perspective, it is to be understood that FCRA, 2010 applies to the persons that include an individual, association including an SHG and other entities as defined under section 2(m) of FCRA, 2010. The text of section 2(m) is reproduced below for your ready reference-

In terms of FCRA, 2010 "person" includes:

i) an individual;
ii) a Hindu undivided family;
iii) an association;
iv) a company registered under section 25 of the Companies Act, 1956 (now Section 8 of Companies Act, 2013).

The FCRA, 2010 further defines the term 'association' under section 2(1)(a) as follows:

> *"association means an association of individuals, whether incorporated or not, having an office in India and includes a society, whether registered under the Societies Registration Act, 1860 (21 of 1860), or not, and any other organisation, by whatever name called;"*

Hence, SHG is an 'association' and falls under the definition of person under FCRA, 2010. In light of the above, giving any amount to SHG out of Foreign Contribution is prohibited but the amounts given to the ***individual members of SHG for their end use as beneficiaries*** can be claimed as program expenses by the NPO. In other words, individual beneficiaries can be provided support for self-consumption. However, we wish to reiterate that no FC can be transferred either to SHG or the member as a sub-grant. Further as discussed earlier, there should be a systematic criterion to establish the eligibility and selection of the beneficiary and the amount or asset which could be given to each beneficiary should be given in a reasonable manner.

Clarifications on Form 10BD

Background to the FAQs

The new reporting requirement covers only clause (viii) and clause (ix) of sub-section (5) of section 80G or under sub-section (1A) of section 35. In other words, many other charitable institutions notified under section 80G are not required to file Form 10BD. From a donor point of view, only those 80G donations will be reflected against the PAN which were provided to organisations covered as mentioned above.

The Form 10BD requires uploading of donation on the basis of:

(i) Identification document other than PAN

(ii) Donation in kind

(iii) Cash donation

For those donations which are uploaded with some other identification number such as Aadhar, Voter ID etc., the donation will not get reflected against the donor PAN.

Moreover, the donee organisation has to mention the section under which donation is eligible for exemption. The certificate of donation generated and downloaded from the system has to be furnished by the organisation to the Donor, though the provision for issuing manual certificate is also there but the process and circumstances under which manual certificate will be issued is not clear.

The Form 10BD requires reporting of donations such as Contribution in Kind which are not eligible under section 80G.

CBDT needs to bring clarity about the reporting requirements which include both eligible and non-eligible donations. In the meanwhile, it is recommended that the following procedures should be followed:

- NGOs should report all donation for which either PAN or any other identification detail is available.

- Donations without identification detail but with proper name and address, ideally, should also be reported. However, it is understood that the Form 10BD requires Identification Number of a donor as mandatory field. It may be noted that to claim 80G benefit and to establish that a donation is not anonymous, it is not necessary to provide any identification number. 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).

- NGOs should not include cash donation exceeding Rs.2000 and donation in kind.

Clarifications on Form 10BD

Q1. Whether the statement of donation is to be filed by all organisations notified or approved under section 80G?

Ans.: The reporting requirements are applicable only to those organisations which are covered under section 80G(5)(vii) or under clause (i) to sub-section (1A) of section 35 of the Income Tax Act, 1961. Therefore, all organisations where approval under section 80G has been granted by order in Form 10AC and Form 10AD shall be covered under this reporting requirement. It may be noted that there are other institutions which are directly notified under section 80G and are not subject to any approval from the CIT or appropriate authority; such organisations are not subject to any such reporting requirement.

Q2. Whether the statement of donation is to be filed for the entire donations received by the organization or only for those donations which are eligible under section 80G(2)(a)(iv) read with section 80G(vi)?

Ans.: In our opinion, the statement of donation should include only those donations which are covered under the scope of section 80G. An NGO receives donations of various kind and from various sources including -

- Foreign Source,
- In kind donations,
- Anonymous donation,
- Donation in cash each exceeding Rs.2000, and,
- Petty donations upto Rs.2000 in cash (where the donor doesn't want 80G benefit and organization has only the name and address of the donor and not the PAN).

It may be noted that the new requirement of filing the statement of donation for claim of 80G benefit is inserted as part of section 80G(5) i.e., the organisations approved by CIT and not to all other notified organisations/funds. Therefore, the intent of the amendment seems to cover only such donation which are eligible for 80G benefit under section 80G(2)(a)(iv) read with section 80(G)(vi).

In the light of the above, there is no need of uploading the details of following donations, which are not eligible for 80G benefit and are not covered under 80G:

- Donation received from Foreign Source (where the donor is not an Income Tax assessee),
- Donation received in Kind,
- Donation received in cash exceeding Rs. 2000/-,
- Anonymous Donations.

However, the Form No. 10BD contains a column regarding donation in kind as one

of the mode of receiving donations even though donation in kind are not eligible for 80G benefit. This requirement in the form is in contradiction to the provisions of section 80G. This issue should be settled by CBDT.

Q3. When donations are received in cash for amount above Rs. 2000/- whether the benefit upto Rs. 2000/- under section 80G is available?

Ans.: It may be noted that 80G benefit is not available for cash donations above Rs. 2000/-, in other words, small donors making donations upto Rs. 2000/- can also avail the benefit under section 80G. However, if a donor makes cash donation in excess of Rs. 2000/-, then no 80G benefit shall be available.

Q4. Will 80G benefit be available, If donations of Rs. 1000/- is received from a donor in every month?

Ans.: In our opinion, if a donor donates more than Rs. 2000/- in cash in a particular year, then 80G benefit will not be available for the entire amount received during the year.

Q5. Whether donation received in pursuance of approval under section 80G(2)(b) are required to be reported in statement of donation?

Ans.: It may be noted that under section 80G(2)(b) certain religious or other institutions of historic, archaeological or artistic importance are notified to receive donations wherein the donor gets tax benefit under section 80G. The current requirement of filing Form 10BD does not cover such institutions.

Q6. Whether petty donations below Rs. 2000/- are to be included in Form 10BD at the option of the NGO?

Ans.: All donations, where the PAN/ Aadhar Number or any other identification such as Passport, Voter ID, Driving License etc. of the donor is available, are required to be reported under Form 10BD.

Q7. What shall be the Pre-Acknowledgement Number at the time of filling up donors details in Form 10BD?

Ans.: At the time of submitting Form 10BD for the first time, the Pre Acknowledgement Number is not required to be filled in as it is generated through portal. It is required to be quoted on the receipt issued to donor after uploading Form 10BD. Pre-Acknowledgement Number is also required to be mentioned at the time of submitting revised statement.

Q8. Whether recurring donations or multiple tranches of grant should be clubbed under single entry or upload the data for multiple receipts?

Ans.: Yes, all the donations received during the year from a particular donor should be clubbed together and reported as a single entry at the end of the year. However, it may be noted that the donations received from the same may have to be segregated in terms of the purpose for which they are received i.e. Corpus, Specific or any other. The donations should also be segregated in

terms of the mode in which they are received i.e. cash, bank, in kind or any other.

Q9. Will the Donation Portal Data be mapped with the Income Tax Return under Voluntary Contributions?

Ans.: The voluntary contribution reported under ITR-7 are consolidated contributions received during the year. Under Form 10BD, only those donations are covered which are specifically applicable to charitable institutions approved by the Commissioner of Income Tax. Therefore, there is a likelihood of mismatch between the voluntary contribution reported under ITR-7 and Form 10BD. If necessary, a reconciliation will be required to be furnished.

Q10. In case where PAN/AADHAR Card of the donor is not available, can the NGO opt for not including these names in the statement of donation?

Ans.: In our opinion, PAN/ Aadhar Number or any other identification such as Passport, Voter ID, Driving License etc. is necessary for uploading of the donor details. In cases where PAN/Aadhar Card is not available then such details cannot be uploaded as the identification of donor seems to be a mandatory field. However, any material mismatch between the donations received and donations reported under Form 10BD will create an onus on the NGO to establish that such donation are not anonymous under section 115BBC. Therefore, to avoid any material mismatch, an NGO should report all the donation where any of the specified identification number of the donor is available.

Donations without identification detail but with proper name and address, ideally, should also be reported. However, it is understood that the Form 10BD requires Identification Number of a donor as mandatory field. It may be noted that to claim 80G benefit and to establish that a donation is not anonymous, it is not necessary to provide any identification number. 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).

Q11. Can an organisation file multiple Form 10BD?

Ans.: Under the Income Tax Rules, there is no specific provision barring multiple filing of Form 10BD. Moreover, the notes below the online Form 10BD makes it clear that Form 10BD is allowed to be filed multiple times for the same financial year. Hence, in our opinion, an organisation can file multiple Form 10BD.

Q12. Whether multiple Form 10BD can be submitted only if the donation list exceeds 25000 in number?

Ans.: NGO in normal circumstances should file additional Form 10BD if the number of donor exceed 25000. However, the law allows filing of multiple forms even if the number of donors does not exceed 25000.

Q13. Whether an NGO can furnish multiple Form 10BD based on its

convenience (say for each region in case of NGO having operation throughout India)?

Ans.: A normal circumstances a consolidated Form 10BD should be filed. However, an NGO can file multiple forms keeping in view the nature of the organisation and practical needs.

Q14. Whether the same NGO can submit 2nd Form 10BD if some donors are not included inadvertently?

Ans.: The NGOs should file additional Form 10BD in case of any such eventuality.

Q15. When and How Form 10BD can be rectified?

Ans.: As per Rule 18(7) the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be, shall lay down the procedure to submit correction statement for rectification or to add/delete or update the information furnished. However, the procedures are yet to be specified.

Q16. If no donation is received, whether Nil return is to be submitted?

Ans.: The current Form 10BD does not seem to be allowing filing of Nil returns.

Q17. What is the status of donation received through Fund raising portal?

Ans.: When donations are received from fund raising portals then the following procedure should be adopted:

- If the detail of donors with PAN or any other identification is provided by the portal then the data should be uploaded specifying specific donor details.

- If the detail of donors with PAN is not provided by the portal then the data should be uploaded specifying PAN and details of the portal. In other words, the legal holder of the portal should be treated as the donor. It may be noted the portal may make donation in representative capacity or individual capacity. The donee organisation has to treat the legal transfer based on the information available.

- When funds are received for different purposes from the same donor then purpose wise classification should be made in the manner discussed above.

Q18. How to report if consolidated cheque received on behalf of various person.

Ans.: When a consolidated cheque is received then:

- If the detail of back donors with PAN or any other identification is available then the data should be uploaded specifying specific donor details.

- If the detail of the back donors with PAN or any other identification is not provided by the donor then the data should be uploaded specifying PAN and detail of the bank account holder from where the cheque was issued.

In other words, the donor can transfer the donations in representative capacity,

if the detail of the back donors is available, otherwise the transferor shall be treated as the donor.

Further, the value of the donation or the aggregated value of all the donations shall be proportionately attributed to all the persons, in a case where the donation is recorded in the name of more than one person, and where no proportion is specified by the donors, attribute equally to all the donors.

Q19. Whether certificate of donation is to be prepared manually or should be downloaded from the portal itself?

Ans.: We understand the certificate of donation should be downloaded from the portal after submission of statement of donation. (Please refer Rule-18AB). However, a confusion is created as in Form No. 10BD, Part B, Note (5) which states as under:

> ***"The generation of Pre-Acknowledgement Numbers for manual issue of Form 10BE is available from F.Y. 2022-23. If you are filing Form 10BD for F.Y. 2021-22 you may leave the field 'Pre-Acknowledgement Number' blank in the CSV file uploaded."***

For the FY 2021-22, there is no mechanism for generating manual Form 10BE, therefore, it is expected that FY 2022-23, some clarity will be provided by CBDT. Currently, though there is a mention for manual issue of Form No. 10BE, however, it seems the certificate in Form 10BE will be system generated and not manual.

Q20. Companies who are categorised as foreign sources, having PAN, and have given grants under CSR do require donation receipt and would claim tax benefit. How should we ensure its reconciliation, as this would be considered as income from foreign source in Income Tax returns?

Ans.: Donations received from all companies registered in India should be reported in Form 10BD, even if it is treated as foreign contribution for FCRA purposes.

Q21. Whether CSR grant, on which TDS has been deducted, shall be subject to statement of donation?

Ans.: If the NGO has treated the CSR receipt as specified grant or donation then such grant or donation should be reported in Form 10BD irrespective of the TDS treatment by the donor. However, if the CSR funds are received under a commercial contract then they are not required to be reported.

Q22. Certain CSR companies have opted for the lower tax regime due to which no more claim deductions/ exemptions apply and hence they do not claim deduction of donations, if any paid u/s 80G from FY 2019-20 onwards. Whether in such cases, NGO need to submit details of such CSR companies in Form 10BD or they can exclude after taking a written confirmation from the concerned CSR companies?

Ans.: Statutory reporting cannot be optional at the discretion of either donor or

the donee. In our opinion, irrespective of tax treatment, NGOs should report all donations and grants received under CSR in Form 10BD. A donation should not be reported in 10BD only if the donor does not provide PAN and other detail. In such cases, the organisation will be under the risk of being questioned for receiving anonymous donation in the light of the failure to report in Form 10BD.

Q23. Donations received for programs, where we do not have any agreement with the Donor except for a mail conversation mentioning the program/ purpose. Should this be classified under Others or Specific Grant?

Ans.: If the mail conversation provides clear direction regarding the use of funds, then they should be classified as specific grants.

Q24. Online donations received for a purpose - what should be the classification?

Ans.: Such donations should be classified as specific grants.

Q25. Donation received from an individual with particular direction for utilization and no agreement is prepared - what should be the classification?

Ans.: Such donations should be classified as specific grants, provided such direction is in writing.

Q26. What is the reporting requirement for anonymous donation?

Ans.: Anonymous donations are not required to be reported under Form 10BD. However, anonymous donation can be exempt or taxable based on the quantum of donation and also the nature of the organisation. Anonymous donation upto 5% of total income are not subject to tax. Further, anonymous donation received by a partly charitable and partly religious organisation is also totally exempt from tax.

Q27. Can an Indian donor request to exclude its name from Form 10BD?

Ans.: No, statutory reporting cannot be optional at the discretion of either donor or the donee. If the NGO possesses the PAN and other details, it has to upload the information in Form 10BD. Otherwise also, it is not advisable to exclude material amounts from Form 10BD in the light of the provisions of 115BBC regarding anonymous donation which may result needless clarificatory processes before the Assessing Officer.

Q28. Can an Indian Corporate CSR Donor request to exclude its name from Form 10BD?

Ans.: No, statutory reporting cannot be optional at the discretion of either donor or the donee, as discussed above.

Q29. Can a Government agency or a public sector corporate request to exclude its name from Form 10BD?

Ans.: No, statutory reporting cannot be optional at the discretion of either donor or the donee, as discussed above. However, certain government agencies may not have PAN number or may not be Income Tax assessees, in such circumstances their name may be excluded.

Q30. What is the reporting requirement when one 80G registered NGO gives inter charity donation to another 80G registered NGO?

Ans.: An NGO registered under section 12AB cannot claim the benefits of section 80G even if it donates to other 80G registered organisation, because such NGOs are exempt from Income Tax under section 11. However, Form 10BD is a factual reporting requirement and in our opinion, the recipient NGO should report all donations received in Form 10BD including donations/ grant from 80G registered organisation.

The 80G registered NGOs who provide donation to other 80G registered NGOs may need 80G benefit, if the benefits of section 11 are denied for some reason during the assessment or they do not claim benefits of section 11.

Q31. Is Form 10BE (Certificate of Donation) is required to be served/sent to the donors?

Ans.: Once an organisation uploads Form No. 10BD (Statement of Donation), it can download Form No. 10BE (Certificate of Donation) from the income tax portal. This Certificate of Donation is generated individually for each donor. This Form 10BE (Certificate of Donation) is required to be sent to the respective donor either by email or any other mode. The Form No. 10BE shall deemed to have been furnished only when this is sent to respective donors.

This is to be noted that requirement is to furnish Form 10BE on or before 31st May. Hence, we understand that Form No. 10BD (Statement of Donation) should be furnished much in advance so that, there is time to generate Form No. 10BE (Certificate of Donation) and furnish the same to respective donor.

Q32. What should be the classification for online donations received for a purpose?

Ans.: The classification should be based on the purpose specified as per online portal. However, for corpus donation a written direction would be necessary and therefore, such donations should be treated as voluntary contribution.

Q33. What should be the classification for donations received from individuals with directions over mail but without any formal agreement?

Ans.: The classification should be based on the purpose specified as per formal mail i.e., it could be treated as specific grant or voluntary contribution as the case may be. However, it should be noted such specific grant should not be treated as a legal obligation which are not treated as income for the purposes of computation under section 11.

Q34. Should donations be filed based on accrual basis or receipt basis?

Ans.: The donation should be reported on receipt basis, however, cheque deposited but not cleared within 31st March may be reported. It is pertinent to note that section 11(1) of Income Tax Act uses the word receipt with regard to computation of income.

Overview of the Law Pertaining to Section 80G & Form 10BD, 10BE

Overview of the 80G Related Provisions

The deduction under section 80G is available for donation made to various specified funds and it covers donation made to any other fund or institution as covered by section 80G(2)(a)(iv).

Section 80G(5) provides that any institution or fund can be approved for the purpose of section 80G(2)(a)(iv), only if it is established in India for a charitable purpose and fulfils the following specified conditions:

(a) Income derived by such fund or institution is exempt under section 11 or section 12 or section 10(23AA) or section 10(23C).

(b) The bye-laws shall not contain any provision for spending the income or assets of the organisation for purposes other than charitable purpose. However, under 80G(5B), it is provided that upto 5% of religious activity shall be permissible.

(c) The organization shall not be established for any particular religious community or caste. This condition will not apply to organizations established for scheduled tribes, scheduled castes, backward classes, or for women and children.

(d) The organization shall maintain regular accounts of receipts and expenditure.

(e) The organisation should be properly registered under various forms of registration or should be a recognized university or an educational institution.

Section 80G is not applicable to donations in kind. Donations in the form of money only are eligible.

In the light of section 80G(5B), where it is provided that upto 5% of religious activity shall be permissible, an organisation can be charitable cum religious. Further, in the case of *CIT v. Dawoodi Bohara Jamat [2014]* 43 taxmann.com 243/222 Taxman 228 (Mag.), the Supreme Court of India also held that a trust carrying on its objectives with dual purposes, i.e. charitable and religious purposes would not be denied registration under section 12AA.

The Finance Act, 2020 has posed an obligation to file a statement of donations by Non-Governmental Organizations (NGO) in respect of donations received. Hence, by virtue of amendments by the Finance Act, 2020, deduction on account of

donation under section 80G shall be allowed to the donor only on the basis of the statement filed by the donee trust or institution. The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 has deferred this requirement to furnish the statement or issue certificate of donations to 01-04-2021.

Any person donating more than Rs.2,000/- in cash to a charitable organization shall not be eligible for the benefits under section 80G. Although, there is no such bar on the NGOs to receive cash in excess of Rs.2,000/-, the restriction imposed is only on donor i.e. the deduction of donation shall not be allowed if donation is made for more than Rs.2,000/- in cash. It is also be noted that in such cases, NGO should not issue receipts which are certifying that donations are eligible for exemption u/s 80G.

A donor can get benefit on donations upto ten per cent of the gross total income (as reduced by any portion thereof on which income-tax is not payable under any provision of this Act and by any amount in respect of which the assessee is entitled to a deduction under any other provision of this Chapter). In other words, the maximum permissible qualifying amount under 80G shall be 10% of gross total income and further the deduction shall be limited to 50% of the qualifying amount unless the donation is made to specified funds eligible for 100% deduction.

Section 80G has been amended with effect from 1st April 2021 in respect of the requirements regarding approval, the period for which approval shall be granted, and the time within which the approval order has to be given by Principal Commissioner or Commissioner.

The category/ circumstances for seeking approval can be classified in the following categories:

(a) All Institutions approved under section 80G before 1st April 2021, i.e. all institutions approved under section 80G up to 31-03-2021.

(b) Provisional approval and the process of making the provisional approval into normal approval.

(c) Renewal of approval granted under new provisions of Section 80G where approval is due to expire.

All the existing approved entities need to apply for re-approval within three months from 1st April 2021 i.e. on or before 30th June 2021 (Extended to 31st March 2022) failing which registration granted under section 80G shall be withdrawn. No enquiry is proposed to be made and approvals shall be granted within a period of three months from the end of the month in which the application was made. The approval granted shall be valid for five years.

Provisional approval shall be granted for three years for new organisation and that too without any enquiry. However, in such cases application for normal approval to be made at least 6 months before the expiry of the period of the provisional approval or within 6 months of commencement of its activities, whichever is earlier. Normal approval shall be granted after such enquiry

as provided in the act and the approval granted shall be valid for five years from the first of the assessment years for which it was provisionally registered.

The application for renewal of approval granted under amended Act has to be made at least 6 months prior to expiry of the period of approval. The approval shall be granted after such enquiry as provided in the Act and the approval granted shall be valid for five years.

Summary of New Scheme for Statement of Donation and Certificate for Donation

This is a major procedural shift made by Finance Act, 2020, now onwards the donor will find its entitlement to 80G only if the statement of donations is already uploaded against his PAN.

Finance Act, 2020 has inserted clauses (viii) and (ix) in section 80G(5) requiring trust or institution approved under section 80G to file a statement of donations received and also to issue the certificate to the donor. It has been further stated that deduction on account of donation under section 80G shall be allowed to the donor only on the basis of the statement filed by the donee trust or institution. Hence, if a statement of donations is not filed, the donor will not get a deduction for the donation under section 80G.

The Amendment Act, 2020 defers this requirement to furnish the statement of donation or issue a certificate of donations to 01-04-2021. Hence, donation received during the FY 2021-22 shall be subject to new mechanism and therefore:

a. Statement of particulars required to be furnished by reporting person shall be furnished in respect of each financial year, beginning with the financial year 2021-22, in Form No. 10BD

b. Form No. 10BD shall be furnished on or before the 31st May, immediately following the financial year in which the donation is received.

c. The certificate referred to in sub-rule (6) in Form No 10BE is required to be furnished to the donor on or before the 31st May, immediately following the financial year in which the donation is received.

Requirement of Statement of Donation

Section 80G(5)(viii)- the institution or fund prepares such statement for such period as may be prescribed and deliver or cause to be delivered to the prescribed income-tax authority or the person authorized by such authority such statement in such form and verified in such manner and setting forth such particulars and within such time as may be prescribed.

Provided that the institution or fund may also deliver to the said prescribed authority, a correction statement for rectification of any mistake or to add, delete or update the information furnished in the statement delivered under this sub-section in such form and verified in such manner as may be prescribed.

Requirement of Certificate of Donation

Section 80G(5)(ix) - the institution or fund furnishes to the donor, a certificate specifying the amount of donation in such manner, containing such particulars and within such time from the date of receipt of donation, as may be prescribed.

Claim of 80G Benefit

Explanation 2A of section 80G - For the removal of doubts, it is hereby declared that claim of the assessee for a deduction in respect of any donation made to an institution or fund to which the provisions of sub-section (5) apply, in the return of income for any assessment year filed by him, shall be allowed on the basis of information relating to said donation furnished by the institution or fund to the prescribed income-tax authority or the person authorized by such authority, subject to verification in accordance with the risk management strategy formulated by the Board from time to time.

80G(5A) - Where a deduction under this section is claimed and allowed for any assessment year in respect of any sum specified in sub-section (2), the sum in respect of which deduction is so allowed shall not qualify for deduction under any other provision of this Act for the same or any other assessment year.

Budget Speech and Memorandum 2020

While presenting the Union Budget for 2020-21 on 1st February 2020, the Finance Minister Nirmala Sitaraman acknowledged the role of charitable institutions in the society. Her budget speech for charitable organizations and new initiatives taken by the government is reproduced below -

Acknowledging the important role played by the charitable institutions in the society, the income of these institutions is fully exempt from taxation. Further, donation made to these institutions is also allowed as deduction in computing the taxable income of the donor.

Currently, a taxpayer is required to fill the complete details of the donee in the income tax return for availing deduction.

In order to ease the process of claiming deduction for donation, it is proposed to pre-fill the donee's information in taxpayer's return on the basis of information of donations furnished by the donee. This would result in hassle-free claim of deduction for the donation made by the taxpayer.

Further, in order to claim the tax exemption, the charity institutions have to be registered with the Income Tax Department. In the past, the process of the registration was completely manual and scattered all over the country.

In order to simplify the compliance for the new and existing charity institutions, I propose to make the process of registration completely electronic under which a unique registration number (URN) shall be issued to all new and existing charity institutions. Further, to facilitate the registration of the new charity institution which is yet to start their charitable activities, I propose to allow them provisional registration for three years.

Memorandum: Filing of statement of donation by donee to cross-check claim of donation by donor. It may further be mentioned that certain provisions of the Act provide that an exempt entity may accept donations or certain sum for utilisation towards their objects or activities in respect of which the payer, being the donor, gets deduction in computation of his income. At present, there is no reporting obligation by the exempt entity receiving donation/ any sum in respect of such donation/ sum. With the advancement in technology, it is now feasible to standardise the process through which one-to-one matching between what is received by the exempt entity and what is claimed as deduction by the assessee. This standardisation may be similar to the provisions relating to the tax collection/ deduction at source, which already exist in the Act. Therefore, the entities receiving donation/ sum may be made to furnish a statement in respect thereof, and to issue a certificate to the donor/ payer and the claim for deduction to the donor/ payer may be allowed on that basis only. In order to ensure proper filing of the statement, levy of a fee and penalty may also be provided in cases where there is failure to furnish the statement. Hence, it is proposed to amend relevant provisions of the Act to provide that,-

(i) Similar to exemptions under clauses (1) and (23C), exemption under clause (46) of section 10 shall be allowed to an entity even if it is registered under section 12AA subject to the condition that the registration shall become inoperative. If the entity wishes to make it operative in the future, it will have to file an application and then it would not be entitled for deduction under clause (46) from the date on which the registration becomes operative.

(ii) The registration under section 12AA would also become inoperative in case of an entity exempt under clause (23C) of section 10 as well, to have uniformity. The condition about making it operative again would also be similar to what is proposed for clause (46) of section 10.

(iii) An entity approved, registered or notified under clause (23C) of section 10, section 12AA or section 35 of the Act, as the case may be, shall be required to apply for approval or registration or intimate regarding it being approved, as the case may be, and on doing so, the approval, registration or notification in respect of the entity shall be valid for a period not exceeding five previous years at one time calculated from 1st April, 2020.

(iv) An entity already approved under section 80G shall also be required to apply for approval and on doing so, the approval, registration or notification in respect of the entity shall be valid for a period not exceeding five years at one time.

(v) Application for approval under section 80G shall be made to Principal Commissioner or Commissioner.

(vi) An entity making fresh application for approval under clause (23C) of section 10, for registration under section 12AA, for approval under section 80G shall be provisionally approved or registered for three years on the basis of application without detailed enquiry even in the cases where activities of the entity are yet to begin and then it has to apply again for approval or registration which, if granted, shall be valid from the date of such provisional registration. The application of registration subsequent to provisional registration should be at least six months prior to expiry of provisional registration or within six months of start of activities, whichever is earlier.

(vii) The application pending for approval, registration, as the case may be, shall be treated as application in accordance with the new provisions, wherever they are being provided for.

(viii) Deduction under section 80G/ 80GGA to a donor shall be allowed only if a statement is furnished by the donee who shall be required to furnish a statement in respect of donations received and in the event of failure to do so, fee and penalty shall be levied.

(ix) Similar to section 80G of the Act, deduction of cash donation under section 80GGA shall be restricted to Rs 2,000/- only. These amendments will take effect from 1st June, 2020.

Relevant Income Tax Rules

The Central Board of Direct Taxes (CBDT) has notified the Income-tax (6th Amendment) Rules, 2021 on 26th March 2021 which shall come into force on the 1st day of April, 2021. New Rule 18AB has been inserted for furnishing of statement of particulars and certificate under clause (viii) and clause (ix) of sub-section (5) of section 80G or under sub-section (1A) of section 35.

Salient Features of the Rule

The reporting person shall, while aggregating the amounts for determining the sums received for reporting in respect of any person, take into account all the donations of the same nature paid by that person during the financial year.

The value of the donation or the aggregated value of all the donations shall be proportionately attributed to all the persons, in a case where the donation is recorded in the name of more than one person, and where no proportion is specified by the donors, attribute equally to all the donors.

Form No. 10BD shall be furnished electronically under digital signature, if the return of income is required to be furnished under digital signature. In other cases, it shall be submitted through electronic verification code.

Form No. 10BD shall be verified by the person who is authorized to verify the return of income under section 140, as applicable to the assesse.

The reporting person shall furnish the certificate to the donor in Form No. 10BE specifying the amount of donation received during financial year from such donor.

The certificate is required to be furnished to the donor on or before the 31st May, immediately following the financial year in which the donation is received.

If there is any mistake in the aforesaid statement or any addition, deletion or updation is warranted in it, then the institution or fund may also deliver to the said prescribed authority, a correcting statement for rectification of the information furnished in the statement in prescribed form and verified in prescribed manner.

Notes Given Below the Form No. 10BD

- To read the instructions before filing the CSV.
- Please convert the file to .csv before uploading.
- Maximum number of rows that can be added in a CSV file is 25000, to add more records you need to file another Form 10BD.
- Form 10BD is allowed to be filed multiple times for the same financial year.
- The generation of Pre-Acknowledgement Numbers for manual issue of Form 10BE is available from FY 2022-23. If you are filing Form 10BD for FY 2021-22, you may leave the field 'Pre-Acknowledgement Number' blank in the CSV file uploaded.

Fees & Penalties

In case of delay in filing such statement or in furnishing certificate of donation, a late fee of Rs.200/- per day shall be applicable under newly inserted section 234G of the Income-tax Act.

Further, a penalty under section 271K, which shall not be less than Rs.10,000/- and which may extend up to Rs.1 lakh, shall be leviable if the trust or institution fails to file such statement or fails to furnish certificate of donation.

Step By Step Procedure to File Form 10BD

After login into to portal under e-file option, select the Income Tax forms and then file Income Tax Forms.

Under the forms, there are three options available viz

- Persons with business/ Professional income,
- Persons without business/ Professional income, and
- Persons not dependent on any source of Income (source of income not relevant).

The option to select Form 10BD is "Persons not dependent on any source of Income (source of income not relevant)".

Under the above option one needs to select form "Tax Exemptions and Reliefs (Form 10BD) and click on "File Now".

Upon clicking "File now", it will take you to next screen i.e.

- "Statement of Particulars to be filed by reporting person u/s 80G(5)/ 35(1A)(i)".

Under this tab, one needs to select the Filing Type - whether the form being filed is Original (Fresh) or Revised and then select the financial year for which form is being filed [currently only FY 2021-22 is available].

Once financial year is selected, the Continue button will get activated and then click on the continue button.

The next screen that appears is :

- "File statement of particulars to be filed by reporting person u/s 80G(5)/ 35(1A) (i) [Form 10BD]".

Once you select this tab, then click on "Let's get started".

Upon clicking on let's get started, a tab for providing details for each section will appear under which:

- "Basic Information" (PART A),
- "Details of Donors and Donations" (PART B), and
- "Verification" (PART C) will appear.

Click on each of them one by one and complete the process by providing details of person responsible for filing the Form 10BD with DSC or EVC.

After filing Form 10BD, download Form 10BE which provide ARN for each of the donation's detail.

Do not forget to Issue the Form 10BE to the donors.

Capital Gains - Applicability of Provisions of Section 50C to NGOs

Applicability of Section 50C and Section 11(1A)

Section 50C of the Income Tax Act, 1961 is applicable when the consideration received or accrued on transfer of capital assets (building or land or both) is less than the value adopted by State Stamp Duty Valuation Authority. Under section 50C read with Section 48, if the property is transferred or sold below the circle rate or the stamp value then the stamp value of the property shall be deemed to be full value of consideration received or accruing as result of transfer.

In other words, section 50C is a **deeming provision** where value as per the State Stamp Duty Valuation Authority shall be deemed to be full value of consideration for the purpose of capital gain in cases where sale consideration is lower than stamp duty valuation.

Section 11(1A) provides that for the purpose of section 11(1), where a capital asset held wholly for charitable or religious purpose is transferred, and the whole or any part of the net consideration is utilized for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified thereunder.

It would also be pertinent to note that section 50C was inserted into the Income Tax Act much after section 11(1A) was introduced. However, the legislature has not chosen to amend section 11(1A) after the insertion of section 50C.

Section 11(1A) was brought into the statute to do away with the erosion of the corpus. Thus, when the intention of the Legislature was to ensure that there is no erosion of corpus by way of requiring application of actual income, it can never be the intention of the Legislature to import section 50C into section 11(1A) and require the application or utilization of an artificial sum, thereby eroding the corpus.

It can never be the intention of the Legislature to give a benefit with one hand and then take the same away with the other. Hence, a sincere attempt must be made to reconcile the provisions to ensure that the benefit given by the legislature is not taken away. In this regard, reference may be made to the judgement of **Goodyear India Ltd. Vs. State of Haryana [1991] 188 ITR 402(SC).**

Judicial Precedence on Non Applicability of Section 50C

The trust registered under section 12AB of the Income Tax Act, 1961 are subject to sections 11, 12 & 13 and normal provisions

under various heads of income are not applicable. Therefore, Section 50CA, being part of provisions related to income from capital gain, has no applicability to a trust registered under section 12AA of the Income Tax Act, 1961.

The capital gain of a charitable or religious organisation is required to be computed under section 11(1A) of the Income Tax Act.

It has been specifically held that the provisions of section 50C are not applicable to charitable organisations registered under section 12AB; in other words, section 11(1A) cannot be substituted with section 50C. In the case of *ACIT-1 Kanpur v. Upper India Chamber of Commerce* ITA 601/LKW/2011, it was held that section 50C is not applicable to charitable organisation. The other cases relevant in this regard are as under:

i. *Sri Guru Dattatreya Mattumv. Income Tax Officer (Exemptions)* Ward Guntur, **2020 (3) TMI 543 - ITAT Visakhapatnam.**

ii. *DCIT v. Saife Jubilee High School* (Ahmedabad ITAT ITA No. 2301/Ahd/2014) [2018 (11) TMI 540 - ITAT Ahmedabad]

iii. *ACIT-1 Kanpur v. Upper India Chamber of Commerce* ITA 601/LKW/2011 [2014 (11) TMI 395 - ITAT Lucknow]

iv. *CIT v. Thiruvendgadam Investments Pvt. Ltd.* 2009 (12) TMI 48 - Madras High Court.

In the light of the above judgments, the deemed fair market value of the property cannot be considered for the purposes of the calculation of capital gains, as the provisions of section 50C of the Income Tax Act, 1961 cannot be invoked and the assessment of charitable organisations is required to be completed by following the provisions of section 11(1A) which is a separate code for taxation of capital gains.

Further, 'Net Consideration' and 'cost of the transferred asset' for the purposes of section 11(1A) of the Income-tax Act, 1961 has been separately defined in the Explanation to the said section.

It is apparent from the above that though, the cost of transferred assets is computed as per the provisions of sections 48 and 49, determination of net consideration for the purposes of the said section has no reference to sections 48 and 49. It is computed as defined in Explanation to this section.

Further, the provision of section 11(1A) are specific provisions whereas provisions of section 50C are general provisions and that provisions of section 50C do not start with a non obstante clause. Thus, as per the rules of interpretation, specific provisions override general provisions. The principle is *Generalia Specialibus Non Derogant* which implies that general provisions must yield to the special provisions. Moreover, the sections in the Act do not overlap one another and each section deals only with the matter specified therein and goes no further. If a case appears to be governed by either of two provisions, it is clearly the right of the assessee to claim that he should be assessed under the one, which leaves him with a lighter burden.

The literal meaning of the expression *'Generalia Specialibus Non Derogant'* is that general words or things do not derogate or detract from the specific. The Courts have held the expression to mean that when there is a conflict between a general and special provision, the latter shall prevail, as held in the cases of *CIT v. Shahzada Nand & Sons [1966] 60 ITR 392 (SC) and UOI v. Indian Fisheries (P.) Ltd.* AIR 1966 SC 35, or the general provisions must yield to the special provision.

Thus, by virtue of the above, specific provisions, whether they apply to taxing of capital gains or to the definition of 'Net Consideration', section 11(1A) being a section enacted specifically for the trusts shall prevail over section 50C.

Non-Applicability Five Heads and CBDT Circular

Section 11 of the Income-tax Act deals with computation of income from property held for charitable and religious purposes. Section 11(1) provides the incomes that shall not be included in the total income of the previous year of the person in receipt of the income.

It is well settled that the 'income' as referred to in section 11(1) must be computed in accordance with commercial principles and not in accordance with the ordinary provisions of the Act. In other words, section 14 and five heads of income will not apply to organisation registered under section 12AB.

The CBDT Circular 5-P (LXX-6) Dt.19th June 1968 has clarified that the word 'income' in section 11(1)(a) must be understood in a commercial sense and five heads of income as per section 14 are not applicable. This circular has specifically included that *where the trust derives income from house property, interest on securities, capital gains, or other sources, the word "income" should be understood in its commercial sense.*

Judicial Precedence on Non-Applicability of Section 14

In *CIT v. Estate of V. L. Ethiraj* [1982] 136 ITR 12 (Mad.), it was held that income from properties would have to be arrived at in the normal commercial manner without reference to the provisions which were attracted by section 14. In this case, the Court observed that the language of 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. When once the income from the property, as such, is excluded, there is no question of computing the income from the property by applying the provisions of section 14.

'Income' must be Understood in Commercial Sense, and Not as 'Total Income' as Assessed

It is not the 'total income' as would be assessed by the ITO that is relevant for the purpose of investing the funds of the trust or assessing the income of the trust. Taking into account the purpose for which the conditions of section 11(1)(a) are imposed, it would be clear that 'income' to be

considered will be that which is arrived at in the context of what is available in the hands of the assesse subject to an adjustment of any expenses extraneous to the trust - *CIT v. P.S.G. & Sons Charities* 1996 Tax LR 477 (Mad.), See also - *CIT v. Programme for Community Organisation* [1997] 228 ITR 620 (Ker.).

Heads of Income under Section 14 have No Relevance and Question of Allowing Statutory Deductions will Not Arise

The 'income' contemplated by the provisions of section 11 is the real income and not the income as assessed or assessable. Since the income from property held under trust has to be arrived at in a normal commercial manner and when the income from property held under trust as such is excluded, there is no scope of computing the income from property by applying the provisions of section 14 of the Act. Therefore, the question of allowing any statutory deductions as contemplated by the different provisions of the Act dealing with different heads of income in computing the income accumulated does not arise when the trust loses the benefit of accumulation - *Director of Income-tax v. Girdharilal Shewnarain Tantia Trust* [1993] 71 Taxman 150 (Cal.). Therefore, income is computed on commercial sense and not under five heads of income including profit and gains from business.

Separate Provision for Capital Gain [Section 11(1A)]

Hence from the above analysis, it is quite clear that heads of income including capital gain is not applicable for a charitable institution and therefore Section 50C being part of computation provisions of calculating capital gain under the head 'Capital Gain' is not applicable to charitable institution subject to section 11 to 13.

Impossible to Apply which is Not Received

Section 50C is a deeming section to check tax evasion, however, in case of charitable organisation the entire capital gain irrespective of the quantum of consideration received is exempt from tax subject to the conditions under section 11. Therefore, section 50C which taxes the income which was not actually received in the books of account cannot be applied to the charitable organisation for two reasons:

(i) Firstly, unlike normal Income Tax assessees, increase in the capital gain will increase the tax liability. Therefore, there is a possibility that the assessee may under value the transfer of property to save taxes. However, in case of charitable organisation any amount of capital gain will not be subject to any tax even if the organisation keeps such amount in long term fixed deposits with banks. Therefore, there is no question of tax evasion by under valuing the transfer of asset.

(ii) A charitable organisation cannot be expected to either apply or pay taxes on the amount which it has never received. A charitable trust cannot be expected to do the impossible act of applying/ accumulating/ investing a notional consideration that it has neither received nor is going to receive. In this

regard, reference may be made to the judgements in *Krishnaswamy S. Pd. Vs. Union of India* [2006] 281 ITR 305(SC) and *Engineering Analysis Centre of Excellence Private Limited vs. CIT* [2021] 125 taxmann.com 42(SC).

Transfer of Property for Lower Consideration to Interested Persons under Section 13(3)

It is to be noted that Section 13(3) provides a list of persons who are treated as interested persons for the purposes of section 13(2). They are as follows:

(i) author of the trust or founder of the institution;

(ii) person who has made a substantial contribution to the trust or institution, i.e. any person whose total contribution up to the end of the relevant previous year exceeds Rs.50,000;

(iii) where such author, founder or person is a Hindu undivided family, a member of the family;

(iv) any trustee of the trust or manager (by whatever name called) of the institution;

(v) any relative of any such author, founder, person, member, trustee or manager as aforesaid;

(vi) any concern in which any of the persons referred to in (1) to (5) above has a substantial interest.

It is also to be noted that the types of specified benefits u/s 13(2) includes -

- Making available building or property of the trust for the use of the specified persons without charging adequate rent or other compensation, [clause (b)].

- Diversion of income or property of the organization in excess of Rs.1,000 to any of the specified persons, [clause (g)].

Hence, if the sale of trust property including land & building is made at a consideration lower than the value as per the Stamp Valuation Authority then it will tantamount to passing of benefit to a specified person in terms of Section 13(1)(c) read with section 13(2) of the Income Tax Act, 1961 and thereby it shall be subject to tax @ 30% under section 115BBI and this benefit shall also be subject to tax penal provision under section 271AAE.

Section 56 has also been amended by Finance Act, 2022 and it has been provided that the specified person shall also be subject to tax under section 56 for such benefits as specified in section 13(2) is received by them.

Hence, **sale** of trust property including land & building at a lower consideration to specified person shall result into taxation at both the hands i.e.

(i) **In the hands of charity**

a. Income computed on commercial principle i.e on the basis of sale

consideration shall be the income subject to application or subject to section 11(1A),

b. The amount of benefit i.e. excess of value as per the Stamp Valuation Authority over the actual sale consideration shall be subject to Tax @ 30% under section 115BBI and this benefit shall also be subject to penal provision under section 271AAE.

(ii) **In the hands of specified person** as income from other sources subject to tax under section 56.

Further, the transfer of property to interested person for a lower consideration may also lead to cancellation of registration under section 12AB (4) & (5).

Restrictions on Transfer under Indian Trust Act, 1882

There are certain restrictive provisions with regard to transfer of property under the Indian Trust Act, 1882. Normally, the Indian Trust Act, 1882 does not apply to a religious or charitable trust, however, the Allahabad High Court in the case *Mahant Som Giri vs Mahant Ram Ratan Giri And Ors.* on 26 August, 1941, AIR 1941 All 387held that the principles underlying the sections of Indian Trust Act, 1882 should serve as a guide to charitable and religious trust also. The relevant sections of Indian Trust Act, 1882 are as under:

> **"Section 36: General authority of trustee.**-*In addition to the powers expressly conferred by this Act and by the instrument of trust, and subject to the restrictions, if any, contained in such instrument, and to the provisions of section 17, a trustee may do all acts which are reasonable and proper for the realisation, protection or benefit of the trust property, and for the protection or support of a beneficiary who is not competent to contract. 1[***] Except with the permission of a principal Civil Court of original jurisdiction, no trustee shall lease trust property for a term exceeding twenty-one years from the date of executing the lease, nor without reserving the best yearly rent that can be reasonably obtained."*
>
> ***"Section 37: Power to sell in lots and either by public auction or private contract.**-Where the trustee is empowered to sell any trust property, he may sell the same subject to prior charges or not, and either together or in lots, by public auction or private contract, and either at one time or at several times, unless the instrument of trust otherwise directs."*

Thus, in case of charitable and religious trusts, the trustees have an inherent obligation to act in the interest of the trust and its beneficiary and/or in other words, in public interest. Public interest demands that any transfer or alienation of the trust property should be completely transparent, fair and in public interest. It is, therefore, expedient that all transfers of property held by religious or charitable trusts, should be open, by issuance of public notices and/or advertisement. The transfer should be given sufficient publicity to fetch the best offers. Some relevant Judicial pronouncement are as under:

a) In **Mohan Lall Seal & Ors. v Kanak Lall Seal & Ors. G.A. No. 3095 of 2008 C.S. No. 116 of 2008** it has been held that:

"Under Section 36 of the Indian Trust Act, it was necessary to obtain permission of the principal Civil Court of original jurisdiction to execute a long term lease, exceeding 21 years. Even though the trust was a charitable trust to which the Indian Trusts Act did not apply all the principles embodied in the Indian Trusts Act would apply."

b) The **Supreme Court in Committee of Management of Pachaiyappa's Trust vs. Official Trustee of Madras &Anr. AIR 1994 (1) SCC 475,** has held that lease of trust property should be granted by public auction.

c) In **Venugopala Naidu vs. Venatarayulu Naidu Charities AIR 1990 SS 444,** the Supreme Court held that the Court should not permit property belonging to religious and charitable endowments to be transferred by private negotiations.

Therefore, if the sale consideration are found to be lower than the market value, the entire sale transactions may be under scrutiny in terms of specific provision as per Indian Trust Act 1882.

Conclusion

As discussed above, we find section 50C does not have any application in the case of charitable trust. The capital gains shall be computed in commercial sense and shall be subject to section 11(1A). Any other interpretation will lead to the absurd result of requiring a charitable trust to apply/ accumulate/ invest notional gains which have never accrued or arisen to it and this can never be the intention of the Legislature. However, an organisation should be careful about any such transfer to interested person and also be mindful of section 36 and 37 of Indian Trust Act, 1882 which requires that the trustees should follow proper transparent procedure for transfer of trust property.

International Activities of NPOs Outside India

Overview

The Finance Act, 2022 has made amendments with regard to taxation of income applied for activities outside India. It may be noted that under Income Tax laws, there are restrictions on activities outside the country.

Under the provisions of section 11(1)(c) of the Income Tax Act, 1961, income applied on activities outside India is not eligible for exemption unless the following conditions are satisfied:

(a) The charitable organisation 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 exemption.

An organisation can apply to the CBDT for permission to work outside India. The applications seeking approval under section 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.

If an orgnisation incurs expenditure outside India in Contravention of section 11(1)(c) then the entire exemption will not be loss. Income to the extent not applied in India will not be eligible for exemption.

NGOs approved under section 10(23C) may have some activities outside India but to claim exemptions, they should primarily be working in India only. Therefore, one needs to distinguish between an NGO registered under section 12AA/12AB and approved under section 10(23C).

The Finance Act, 2022 inserted a new Section 115BBI to provide a special tax rate for the specified incomes of trust. It provides that any income which is not excluded from total income under section 11(1)(c) i.e., application towards charitable purposes outside India, shall be taxable under Section 115BBI. If there is a clause in the trust deed which provides for activities outside India, it would not dis-entitle the organization from claiming exemption. The provisions of section 11(1)(c) are attracted only if the actual expenditure is incurred outside India.

Legal Issues and Provisions for a Section 12AA/12AB Registered Entity

Under the provisions of section 11 of the Income Tax Act, 1961, income applied on activities outside India is not eligible for exemption unless the following conditions are satisfied:

(a) The charitable organisation 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 exemption for carrying out such activities.

An organisation can apply to the CBDT for permission to work outside India. The applications seeking approval under section 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.

With regard to the Earthquake in Nepal, the Central Board of Direct Taxes had decided to fast track all applications made under section 11(1)(c) of the Income Tax Act, 1961 seeking approval for rendering help to the victims of earthquake in Nepal.

Implication of Expenditure being Incurred in Violation of Section 11(1)(c)

The entire exemption was not lost if an NGO registered under section 12AA/12AB incurred any expenditure outside India in contravention of section 11(1)(c). To the extent not applied in India, income was not eligible for exemption and was subject to tax. In other words, the amount spent was subjected to tax without any benefit of 85% application, i.e. tax has to be paid even if the organisation has applied 85% of income without considering the expenditure outside India.

Hitherto, there was no specific section for taxing the certain income of a charitable institution at a specific prescribed rate and the income were subject to tax in terms of section 164(2).

The Finance Act, 2022 inserted a new Section 115BBI to provide a special tax rate for the specified incomes of trust.

It provides that any income which is not excluded from total income under section 11(1)(c) *i.e.*, application towards charitable purposes outside India, shall be taxable under Section 115BBI.

It shall be taxable at the rate of 30%. Apart from the tax of 30% on the aggregate of specified income, the income tax computed under section 115BBI shall be liable to surcharge and cess.

Further, no deduction regarding 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.

Will Activities Outside India Result in Forfeiture of Entire Income?

The provisions of section 11(1)(c) do not attract forfeiture of the entire income. In other words, if an NGO is willing to pay taxes to the extent of its activities outside India, then to that extent, it can perform such activities. Forfeiture of entire income is not possible because applying funds outside India has not been envisaged as a reason for forfeiture under section 13(1)(a) to 13(1)(d). In the case of *CIT v. State Bank of India* [1987] 32 Taxman 619 (Bom.), the trust had applied income outside India and

the income to that extent only was subjected to Tax.

If an organization incurs expenditure outside India in contravention of section 11(1)(c) then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption. *CWT v. Trustees of H.E.H. Nizam's Religious Endowment Trust* [1977] 108 ITR 229 (AP).

Activity Outside India cannot be a Ground for Rejection under Section 12AA

In the case of *M.K. Nambyar Saarf Law Charitable Trust v. Union of India* [2004] 140 Taxman 616 (Delhi), it was held that registration cannot be denied to charitable or religious trust merely because income is applied outside India. It was held that income applied by a trust or institution outside India is not a relevant criterion for rejecting an application for registration under section 12A and if income is so applied, then section 11(1)(c) will be applicable and if permission is granted by Board either by general or special order, then benefit can be extended.

Enabling Power in Constitution Document to Work Outside India

All organizations should verify whether an enabling clause to work outside India is present in the Constitution/ Trust Deed/ Memorandum of Association. An organisation should see that the area of operation is not specifically restricted to a particular district, State or India as acountry. If it is so restricted, it will not be permissible for them to work outside India without amending the Constitution. In case the Constitution is silent about the area of operation, such organizations may work outside India by passing a special resolution if there is no restrictive clause with regard to area of operation.

Further, the existence of a clause in the registration document which provides for activities outside India, would not dis-entitle the organization from claiming income tax exemptions. ***The provisions of section 11(1)(c) are attracted only if the actual expenditure is incurred outside India.***

Will a Clause of Activities Outside India in the Trust Deed Invite Forfeiture?

If there is a clause in the trust deed which provides for activities outside India, it would not dis-entitle the organization from claiming exemption. The provisions of section 11(1)(c) are attracted only if actual expenditure is incurred outside India. Section 11(1)(c) cannot be invoked only on the ground that the trust deed provides for activities outside India.

In the case of *CIT v. State Bank of India* [1987] 32 Taxman 619 (Bom.), one of the issues was whether a trust for charitable purposes in India and abroad can claim exemption from its income where the trustees have discretion to apply the income either in India or abroad? The trust deed provided, at the discretion of the trustees, to give 45 per cent of the income to the University of Athens. It was held that the trust was eligible for exemption even though it provided for application of income abroad. However, the portion of income actually applied abroad or accumulated for application abroad was not exempt.

Similarly, in *CWT v. Trustees of H.E.H. Nizam's Religious Endowment Trust* [1977] 108 ITR 229 (AP), it was held that the charitable or religious expenditure incurred in India will not be affected by a provision for activities outside India or even actual expenditures abroad. Exemptions towards activities in India remain intact and in the case of a clause in the trust deed empowering the trust to have activities outside India, there is no impact. And in the case of trust having activities outside India, the exemptions will be denied to the extent of the income applied outside India.

Income should Not only be Applied for Charitable Purposes in India but also Applied in India

In the case of *DIT (Exemption) v. National Association of Software & Services Companies* [2012] 21 taxmann.com 213/208 Taxman 178, the High Court of Delhi held that the income of the trust should not only be applied for charitable purposes, but also applied in India to such purposes. It was observed that the interpretation that the words 'in India' qualifies only the words 'such purposes' would not only be contrary to the plain grammatical meaning of section 11(1)(a) but also render the provisions of section 11(1)(c) redundant and otiose. If it was accepted that income of trust can be applied even outside India so long as the charitable purposes are in India, then there is no need for a trust which tends to promote international welfare in which India is interested and was created on or after 1-4- 1952 to apply to the CBDT for a general or special order for exemption.

The High Court interpreted the natural grammatical meaning of the words "to the extent to which such income is applied to such purposes in India" appearing in section 11(1)(a) of the Act. The High Court observed that the word "applied" is a verb in the past tense used in a transitive form followed by words "such purposes" and "India" qualified with two prepositions "to" and "in". This being the case, the words should be read as applicable to charitable purposes and also applied in India to such purposes. For this purpose, the Court relied on a few rules of interpretation laid down in the cases of *Jugal Kishore Saraf v. Rao Cotton Co. Ltd.* AIR 1955 SC 376; *Kanai Lal Sur v. Paramnidhi Sadhukhan* AIR 1957 SC 907 and *Union of India v. Rajiv Kumar* [2003] 6 SCC 516.

Interesting instance observed by the court: The Delhi High Court ruling in *DIT (Exemption) v. National Association of Software and Services Companies* [2012] 208 Taxman 178/21 taxmann.com 213 explained that the literal interpretation of the statute was not, probably in consonance with the intent of the statute. It agreed that it was illogical to allow expenditure paid to a student to study abroad but the same was not permissible if the payment was made directly to the foreign university.

In the case of *India Brand Equity Foundation v. Asstt. CIT (Exemption)* [2012] 23 taxmann.com 323/153 SOT 506 (Delhi - Trib.), it was held that amount spent outside India for participating in a fair held outside India cannot be treated as application of income of trust for purpose of section 11(1)(a).

Supporting Students to Study Outside India

In the case of *Jamsetji Tata Trust v. Jt. DIT (Exemption)* [2014] 44 taxmann.com 447/148 ITD 388 (Mum. - Trib.) with regard to investment in violation of section 11(5), it was held that Education grant given to Indian students for studying abroad fulfils conditions of application of money in order to claim exemption under section 11.

It was observed that the assessee had applied the money for charitable purpose in India and the final execution of the purpose may be outside India but the same will not affect the conditions satisfied by the assessee.

Expenditure incurred in India for Activity Outside India but Serving Charitable Purpose in India is Not covered under Section 11(1)(C)

The Kolkata Tribunal in the case of *Credai Bengal v. CIT (Exemption)* [2017] 88 taxmann.com 764 (Kol.-Trib.) held that there is restriction to apply the income outside India but as per the submission of the assessee all the expenses were incurred in India. The argument of the **ld. AR** is fortified from the details of expenditure, bank statement, receipts & expenditure of foreign fair, participants list. The fair in North America was organized to invite the Indian residents to invest in India in realty sectors. Therefore, the object and activity for the fair in North America was for the advancement of realty business in India. Mostly all the participants were Indian corporate and contributions were received in Indian currency. There was no charitable act done in North America.

Situs of Expenditure and Not to the Place where the Purposes were carried out

In the case of *Bharata Kalanjali v. ITO* [1989] 30 ITD 161, the Madras Bench of the Tribunal made an important observation by holding that the term 'applied to such purposes in India' referred to the situs of expenditure and not to the place where the purposes were carried out. In this case, certain expenditures were incurred for travel outside India and it was held that deduction of such expenses was permissible as they were incurred in India.

Holding Conferences Outside India

In the case of *CEO Clubs India v. DIT (Exemption)* [2012] 25 taxmann.com 217/53 SOT 488 (Mum.-Trib.), it was held that holding of conferences abroad would not make activities of the assessee being carried out outside India. The benefits of such conference will ultimately go to the assessee and its members. It cannot be said that the activities of the assessee were carried on outside India. However, in the light of the NASSCOM's case (supra), this case ruling may be distinguishable.

Section 10(23C) and Activities Outside India

In India, NGOs can be registered under section 10(23C) and also under section 12AA/12AB. NGOs of national importance are granted registration under section 10(23C). It may be noted that unlike section 11(1)(c), the third proviso to section 10(23C)(vi) did not mention the words "in India" with regard to application of funds for charitable and religious purposes.

Therefore, it raises the question whether NGOs registered under section 10(23C) can have some activities outside India. The Supreme Court gave a landmark judgment in *American Hotel & Lodging Association Educational Institute v. CBDT* [2007] 158 Taxman 146 (Delhi). In this case, the assessee NGO was a branch office of an American NGO. It was not doing any charitable activity in India and all its income in India was repatriated to USA.

The Supreme Court was of the opinion that exemption under section 10(23C) was not available if the all the activities were outside India though section 10(23C) does not specifically make it mandatory that the activities be done in India. In other words, the Supreme Court opined that NGOs registered under section 10(23C) should primarily have activities in India to claim exemptions. The Court observes that the absence of words "In India" does not automatically imply "anywhere in the world". In the light of this ruling, it may be concluded that NGOs registered under section 10(23C)(vi) are also required to have activities in India only. However, in the light of the observation of the Supreme Court, they may have some activity outside India as there is no specific bar on working outside India under section 10(23C)(vi).

Therefore, one needs to distinguish between an NGO registered under section 12A and section 10(23C). The former cannot have any activity outside India but the latter may have some activity outside India because section 10(23C) is silent about the location of activities and the Supreme Court opined that such NGOs should primarily be working in India.

Therefore, in either case, to avail tax exemptions in India, the dominant purpose and activity should remain inside India.

Implication if Any Activity is Outside India for a Section 10(23C) Entity

It may be noted that unlike section 11(1)(c), the third proviso to section 10(23C)(vi) does not mention the words "in India" with regard to application of funds for charitable and religious purposes. Therefore, it raises the question whether NGOs registered under section 10(23C) can have some activities outside India though Supreme Court opined that such NGOs should primarily be working in India.

Section 10(23C) has not provided any implication if any entity approved u/s 10(23C) has any activity outside India. However, if the international activities are substantial then in the light of the Supreme Court judgment in *American Hotel & Lodging Association Educational Institute v. CBDT (supra)*, such expenditure may not be considered as applied towards charitable purposes.

Concluding Remarks

All organisations registered under section 12AB should be careful about activities outside India. Further, NGOs may have expenditure towards import of services or expenditure which are incurred outside India for the benefit of Indian beneficiaries. In such cases also, it is recommended that expenditure should be made in or from India. In other words, incurring expenditure physically outside India, even for Indian purposes is not recommended.

Organisations Not Required to Apply for Approval Under 10(23C)

Overview

Charitable and religious institution can avail tax exemptions under section 10(23C) of the Income Tax Act, 1961. To avail tax exemptions, normally, approval of the Commissioner of Income Tax is necessary, however, there are certain type of institutions which are not required to take approval and can claim exemptions directly. In this issue, we are discussing the law applicable to such organisations.

Under sub-clauses (iiiad) and (iiiae) of section 10(23C) of the Income-tax Act, 1961 educational and medical institutions are totally exempt from tax if the annual aggregate receipt does not exceed Rs.5 crores.

The Finance Act, 2021 has increased the limit of said annual receipts, for exemption under sub-clauses (iiiad) and (iiiae) of Section 10(23C), to Rs.5 crores. Earlier, this limit was Rs.1 Crore. The Finance Act, 2021 also provides that the revised threshold limit of Rs.5 crores shall apply for an assessee with respect to the aggregate receipts from university or educational institution as referred to in sub-clause (iiiad) and the hospital or institution as referred to in sub-clause (iiiae). In other words, if a trust running both medical and educational institutes, the annual receipts from all such institutes shall be aggregated and if it does not exceed Rs.5 crores, the exemption shall be available.

Under sub-clauses (iiiab) and (iiiac) of clause (23C) of the Income Tax Act, 1961, educational and medical institutions are totally exempt from tax if they are wholly/ substantially financed by Government.

The condition is that such institutions should be solely for educational or medical purposes.

The income of such organisation shall not be used for any private benefit, but it can be retained in the corpus for future purposes as there is no restriction regarding 85 per cent application of fund.

Only compliance under Income-tax law is the filing of income-tax return in Form ITR-7.

Such organisations are not required to apply for an exemption or obtain approval to claim exemptions.

Such organisations are not required to apply 85 per cent of their income during the previous year.

These organisations are not subject to any audit under the Income Tax Act.

Institutions Directly Exempt

Under sub-clauses (iiiad) and (iiiae) of section 10(23C) of the Income Tax Act, educational and medical institutions are totally exempt from tax if the annual receipt does not exceed Rs.5 crores.

Similarly, under sub-clauses (iiiab) and (iiiac) of clause (23C) of the Income Tax Act, 1961, educational and medical institutions are totally exempt from tax if they are wholly/ substantially financed by Government.

Scheme of Taxation and Conditions for Exemptions

The text of the relevant sub-clauses to section 10(23C) are provided as under:

"(23C) any income received by any person on behalf of— ** ** **

(iiiab) any university or other educational institution existing solely for educational purposes and not for purposes of profit, and which is wholly or substantially financed by the Government; or

(iiiac) 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 and not for purposes of profit, and which is wholly or substantially financed by the Government.

Explanation.— For the purposes of sub-clauses (iiiab) and (iiiac), any university or other educational institution, hospital or other institution referred therein, shall be considered as being substantially financed by the Government for any previous year, if the Government grant to such university or other educational institution, hospital or other institution exceeds such percentage of the total receipts including any voluntary contributions, as may be prescribed, of such university or other educational institution, hospital or other institution, as the case may be, during the relevant previous year; or

(iiiad) any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of the person from such university or universities or educational institution or educational institutions do not exceed five crore rupees; or

(iiiae) 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 and not for purposes of profit, if the aggregate annual receipts of the person from such hospital or hospitals or institution or institutions do not exceed five crore rupees."

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;

Important noteworthy issues are provided as under:

(i) The entire income is exempt under section 10(23C), provided the annual aggregate receipts are up to Rs.5 crore or the institutions are solely or substantially financed by the Government.

(ii) The condition is that such institutions should be solely for educational or medical purposes.

(iii) The income of such an organisation shall not be used for any private benefit. It can be retained in the corpus for future purposes.

(iv) Only requirement is the filing of income-tax return in Form ITR-7.

Conditions and compliances for such organisation are as under:

(i) Such organisations are not required to apply for an exemption or obtain approval to claim exemptions.

(ii) Such organisations are not required to apply 85 per cent of their income during the previous year.

(iii) These organisations are not subject to any audit under the Income Tax Act.

Threshold Limit for Educational Institutions and Hospitals (Increased by the Finance Act, 2021)

Section 10(23C) of the Act provides for exemption of income received by any person on behalf of different funds or institutions etc. specified in different sub-clauses. Under sub-clauses (iiiad) and (iiiae) of section 10(23C) of the Income Tax Act, educational and medical institutions are unconditionally exempt from tax if the annual receipt does not exceed Rs.1 crore.

Sub-clause (iiiad) of Section 10(23C) provides for an exemption for the income received by any person on behalf of the university or educational institution. The exemptions under the clause are available subject to the condition that the annual receipts of such university or educational institution do not exceed the annual receipts as may be prescribed.

Similarly, sub-clause (iiiae) of the said clause provides for an exemption for the income received by any person on behalf of hospital or institution. The exemptions under the clause are available subject to the condition that the annual receipts of such hospital or institution do not exceed the annual receipts as may be prescribed.

Such threshold of the annual receipt is Rs.1 crore which is prescribed under Rule 2BC. It may be noted that under section 10(23C)(iiiad) and section 10(23C)(iiiae), an organisation is not required to get itself registered before any authority and is also not subject to 85% application.

The Finance Act, 2021 incorporated the threshold limit in the provisions itself and it has increased the limit of said annual receipts, for exemption under sub-clauses (iiiad) and (iiiae) of section 10(23C), to Rs.5 crores.

The Finance Act, 2021 also provides that the revised threshold limit of Rs.5 crores shall apply for an assessee with respect to the aggregate receipts from university or educational institution as referred to in sub-clause (iiiad) and the hospital or institution as referred to in sub-clause (iiiae). In other words, if a trust running both medical and educational institutes, the annual receipts from all such institutes shall be aggregated and if it does not exceed Rs.5 crores the exemption shall be available.

Meaning of 'Annual Receipts'

Neither the existing provision nor the provision amended by the Finance Act, 2021 defines the meaning of 'annual receipts'. Since no guidance is available in this respect under the Act, we may rely on the judicial pronouncements in this regard.

The Madras High Court in the case of *CIT v. Madrasa E-Bakhiyath-Us- Salihath Arabic College* [2014] 50 taxmann.com 81 (Madras) held that sale proceeds of land and bonds could not be equated to annual receipts while considering monetary limit under section 10(23C)(iiiad) as the said sale was in nature of the conversion of a capital asset from one form to another. The Jaipur Tribunal in the case of *Indian Medical Trust v. ITO* [2012] 18 taxmann.com 223 (Jaipur) held that the annual receipt is to be considered without excluding contribution towards the corpus of the trust.

Rs.5 Crore Limit to be Applied in Aggregate and Not Per Institution

The Finance Act, 2021 also provides that the revised threshold limit of Rs.5 crores shall apply for an assessee with respect to the aggregate receipts from university or educational institution as referred to in sub-clause (iiiad) and the hospital or institution as referred to in sub-clause (iiiae). In other words, if a trust running both medical and educational institutes, the annual receipts from all such institutes shall be aggregated and if it does not exceed Rs.5 crores, the exemption shall be available.

Earlier the provisions were silent about this aspect. Though there were various court rulings providing that limit of Rs.1 crore to be available for each of the institution run by an organisation. However, there are contrary rulings as well.

For example, if an organisation is running 10 schools and the turnover of each school is less than Rs.1 crore then the exemption was available to the organisation for all the schools without any registration or approval.

Some of the rulings which affirmed this view is as under:

(a) The Karnataka High Court in the case of CIT v. Children's Education Society [2013] 34 taxmann.com 285 (Karnataka) held that if an assessee is having more than one educational institution then the 'aggregate annual receipt' of each such educational institution has to be considered separately. If a trust is running 5

educational institutions then each of such institution will enjoy the Rs.1 crore limit.

(b) The Chennai Tribunal in the case of PKD Trust v. ITO [2017] 79 taxmann.com 282 (Chennai - Trib.) has held that each educational institution should be considered separately for applying threshold annual receipt of Rs.1 crore for allowing exemption under section 10(23C).

(c) The Delhi Tribunal in the case of ACIT v. Shiksha Samiti [2015] 60 taxmann.com 428 (Delhi - Trib.) held that for exemption under section 10(23C)(iiiad), 'aggregate annual receipts' refers to receipts by a particular institution.

The amendment by the Finance Act, 2021 has overruled these judgments. The Finance Act, 2021 substituted the words "receipts of such university or educational institution....." with "receipts of the person from such university or universities or educational institution or educational institutions....." in sub-clause (iiiad) and sub-clause (iiiae).

Further, an Explanation is inserted to clarify that if the person has receipts from educational institutions as referred to in sub-clause (iiiad), as well as from medical 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 educational and medical institutions exceed Rs.5 crores. In other words, if a charitable trust runs both a medical and an educational institute, the total receipts from all such institutions shall be aggregated to compute the annual total receipt of Rs.5 crores. This amendment has overruled various court rulings wherein it was held that limit of Rs.1 crore is to be seen separately for each medical and educational institution.

The amendment by the Finance Act, 2021 affirms the ruling of Amritsar ITAT in the case of ITO v. Vivekanand Society of Education and Research [2014] 48 taxmann.com 386 (Amritsar - Trib.) that if the receipts of an assessee-society from two institutions managed and run by it exceeded Rs.1 crore, in absence of exemption certificate under section 10(23C), receipt was rightly brought to tax.

Limit of Rs.1 Crore/5 Crore Shall Include Additions Under Section 10(23C)(iiiad)

The High Court of Punjab and Haryana in the case of Satluj Shiksha Samiti v. CIT [2019] 107 taxmann.com 54/264 Taxman 315 held that where assessee, incorporated to promote child education, claimed exemption under section 10(23C)(iiiad), in view of fact that assessee's gross annual receipts from fee and interest along with addition made under section 68 exceeded 'one crore, claim so raised deserved to be rejected.

Capital Receipts to Be Excluded from Rs.1 Crore/ 5 Crore Limit

In the case of Deputy DIT (Exemptions)-III v. Madarasa E-Bakhiyath Us - Salihath Arabic College [2014] 41 taxmann.com 8/62 SOT 1 (Chennai - Trib.), it was held that for the purposes of section

10(23C)(iiiad), the turnover shall not include any capital receipt for determination of the one crore limit. In this case, the Assessing Officer had rejected assessee's claim for deduction under section 10(23C)(iiiad) taking a view that its gross annual receipts exceeded rupees one crore during relevant year. It was held that, in view of fact that income earned from sale of land and bonds was of capital nature, it was not includible in annual receipts and, after excluding said amount assessee's gross annual receipts did not exceed prescribed limit.

Section 12AA can be Availed Even if Organisation is Exempt Under Section 10(23C)(iiiad)

The High Court of Punjab and Haryana in the case of CIT (Exemptions) v. Beant College of Engineering & Technology [2019] 108 taxmann.com 196/265 Taxman 449 held that where AO rejected assessee's claim for registration under section 12AA on ground that it had been claiming exemption under section 10(23C)(iiiad), since assessee was free to avail registration under any alternative provision if more than one alternatives were available, impugned order passed by Assessing Officer was to be set aside.

Assessee-trust, running a school, filed application for registration under section 12AA - Commissioner (Exemptions) took a view that assessee had been claiming exemption under section 10(23C)(iiiad) and, therefore, should not have filed application under section 12AA - He further opined that assessee was running a school which had not been reflected in byelaws as objects of society as contained in Memorandum of Association - Accordingly, assessee's application for registration was rejected - As regards first objection, Tribunal was of view that assessee was free to avail registration under any alternative provision if more than one alternatives were available and, thus, assessee was eligible for registration under section 12AA for which it had applied - So far as second objection was concerned, Tribunal concluded that mere non-mentioning of schools and colleges in Memorandum of Association did not dis-entitle assessee for getting registration under section 12AA - Tribunal thus set aside order passed by Commissioner (Exemptions) - Whether since no illegality or perversity could be pointed out by revenue in findings recorded by Tribunal, impugned order allowing assessee's application for registration was to be upheld - Held, yes [Para 5] [In favour of assessee]

The 50% Government Funding Requirement is Prospective in Nature

The ITAT Indore Bench in the case of Deputy Commissioner of Income Tax (Exemption), Bhopal v. Shri Vaishnav Polytechnic College Govn by VSK Market Tech Educational Society [2020] 122 taxmann.com 287 (Indore - Trib.) held that Explanation to section 10(23C)(iiiab) w.e.f. 1-4-2015 setting out minimum threshold of 50 per cent for institution to be financed by Government for claiming benefit of exemption under section 10(23C)(iiiab) is prospective in nature.

This aspect of government financing of less than 50% prior to amendment has been dealt by Hon'ble Madras High Court in the case of CIT v. Indian Institute of Management [2010] 8 taxmann.com 239 wherein the government financing was to the tune of 37.85% was held to be entitled for exemption u/s 10(23C)(iiiab). Also, in the case of CIT v. Jat Education Society, Rohtak [2015] 64 taxmann.com 312 by Hon'ble Punjab & Haryana High Court.

Maintenance of Books of Accounts For NPOs

INTRODUCTION

Prior to the Finance Act, 2022, there was no specific requirement under section 12A to maintain books of account by trusts and institutions. Although, certain provisions made it an implicit requirement to maintain the books of account.

The Finance Act, 2022 has introduced additional condition to maintain books of account by the trusts and institutions under section 12A(1)(b)(i) with effect from the assessment year 2023-24.

The Finance Act, 2022 inserted Section 13(10) and 13(11) with effect from the assessment year 2022-23 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 section.

NGOs can choose the method of accounting based on their requirement, but the Section 8 companies are mandatorily required to follow Accrual Basis Accounting as per the requirement of the Companies Act, 2013, even for section 8 company the computation of income and application should be made as per the provisions of section 11. Under the amended Income Tax laws, the method of accounting is largely on cash basis except for exceptions such as certain income accrued but not received as specified under explanation section 11(1).

The Finance Act, 2022 has inserted a new explanation after sub-section (7) of Section 11, as a result application will be allowed only on cash basis and all expenses also have to be on cash basis, except some exceptions such as depreciation (being a non cash expenditure), which will be permissible as application of income subject to the provision of section 11(6).

Accounting Standards formulated by the ICAI do not apply to an NPO if no part of the activity of such entity is commercial, industrial or business in nature.

Since the five heads of income do not apply to NGOs, the Income Computation and Disclosure Standards (ICDS) shall not apply to NGOs for the computation of income under Sections 11 and 12.

Insertion of Explicit Provision by the Finance Act, 2022

The Finance Act, 2022 amended Section 12A(1)(b), imposing an explicit requirement to maintain books of account by charitable institutions.

Text of Section 12A(1)(b): *"(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) the books of account and other documents have been kept and maintained in such form and manner and at such place, as may be prescribed; and

(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;".

Requirement to Maintain Books of Account

The Finance Act, 2022 amended Section 12A(1)(b) to provide that where the total income of the trust or institution without giving effect to an exemption under Section 10(23C) or section 11 and 12, exceeds the maximum amount which is not chargeable to tax, such trust or institution shall keep and maintain books of account and other documents in such form and manner and at such place, as may be prescribed.

This amendment is effective from the assessment year 2023-24.

Requirement to Maintain Books of Accounts is an Additional Condition

It is to be noted that this condition to maintain books of accounts is in addition to the conditions requiring the trust or institutions to get registration, audit of the books of accounts and filing of return of income. Thus, if the trust fails to comply with any of these conditions, the benefit of exemption under Section 11 and 12 shall not be available.

Applicable if total income exceeds INR 2,50,000

This provision regarding maintenance of prescribed books of account and other documents is applicable only if the total income of the charitable institution as computed under the Act, without giving effect to the provisions of sections 11 and 12, exceeds the maximum amount, which is not chargeable to income tax in the previous year. It is thus, not applicable to institutions whose total income (ignoring sections 11 and 12) is less than or equal to Rs.2,50,000.

Which books of account are to be maintained?

The term' books of account' has been defined in section 2(12A) as under:

"books or books of account" includes ledgers, day-books, cash books, account-books and other books, whether kept in the written form or in electronic form or in digital form or as print-outs of data stored in such electronic form or in digital form or in a floppy, disc, tape or any other form of electro-magnetic data storage device;

Thus, as per the definition under section 2(12A), the books of accounts include the following:

(a) Ledgers
(b) Day-books
(c) Cash books
(d) Account books
(e) Other books

Form and manner and place to maintain the books of account

Section 12A(1)(b) provides that books of account shall be kept and maintained in such form and manner and at such place, as may be prescribed. Thus, the CBDT may come with the rules to prescribe the form, manner and place at which such books of account shall be maintained.

However, Section 2(12A) which defines books of account provides that these books can be kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device.

Further, the Finance Act, 2022 has amended Section 2(12A) to provide that books of account can also be maintained in electronic or digital form. Therefore, such books of account can be stored in electronic form or in digital form or in a floppy, disc, tape or any other form of electro-magnetic data storage device.

Maintain Books of Account was Already an Implicit Requirement

Under the Income Tax Act, ordinary taxpayers are required to maintain books of account and get them audited. The requirement to maintain the books of accounts are prescribed under Section 44AA. Prior to Finance Act, 2022, there was no specific requirement to maintain books of account by trusts and institutions. However, there are various provisions which virtually made it compulsory for Trust and NGOs to maintain books of account. The provisions of the Income Tax Act which make maintenance of books of account an implicit requirement are given in next points.

Requirement to get Audit

One of the conditions for availing exemptions under section 11 and section 12 is auditing the organization's accounts under section 12A(1)(b). As per the prevailing provisions, the audit report must be obtained and furnished at least one month before submitting the income tax return.

The monetary limit for compulsory audit under section 12A(1)(b) is currently Rs.2,50,000. The accounts of the trust should be audited if the total income of the trust or institution as computed under the Income Tax Act, without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount that is not chargeable to income-tax in any previous year.

Since the charitable institutions that have receipts above Rs.2,50,000 are mandatorily required to get accounts audited, so in a way, it is an essential requirement for them to maintain books of account that need to be audited by a Chartered Accountant.

In the audit report in Form 10B, the auditor has to certify that he has examined the balance sheet and the Profit and loss account of the trust or institution, which are in agreement with the books of account maintained by the said trust or institution.

Incidental Business Activity

Income from a business carried on by a trust shall be treated as income from 'property held under trust'. Such business income shall be eligible for exemption under Section 11 if it is incidental to the attainment of objectives of the trust and separate books of account are maintained by the trust in respect of such business.

The Hon'ble High Court of Madras, in the case of *DIT v. Willington Charitable Trust* [2010] 195 Taxman 232 (Madras) held that maintenance of separate books of account is mandatory and a condition precedent for the assessee to seek exemption under section 11. The court observed that, insofar as the compliance of the maintenance of separate books of account required under section 11(4A) is concerned, a reading of the above said provisions would make it clear that it is mandatory and a condition precedent for the assessee to maintain the same while seeking exemption.

Enable ITO to scrutinize accounts

The Hon'ble High Court of Calcutta, in the case of *Commissioner of Income-tax v. Birla Education Trust* [1985] 21 Taxman 134 (Calcutta)/ [1985] 153 ITR 579 (Calcutta) held that the ITO has to scrutinize the accounts and see if there is suppression of income or manipulation of accounts with a view to conceal income.

Submission of audited accounts at the time of registration

Application for registration/ approval under the new scheme of registration/ approval effective from 01-04-2021 for charitable and religious entities registered/ approved under section 12A/ 12AA/ 12AB/ 10(23C)/ 80G/ 35 is to be filed in Form 10A/ Form 10AB.

Rules provide the list of documents to be furnished while making the application in Form 10A or 10AB. One of the prescribed attachment is that where the applicant has been in existence during any year or years prior to the financial year in which the application for registration is made, self-certified copies of the annual accounts of the applicant relating to such prior year or years (not being more than three years immediately preceding the year in which the said application is made) for which such accounts have been made up.

Requirement under Section 80G

Deduction under section 80G is allowed when a person makes a donation to a fund or institution specified in the provision itself or is notified by the tax authorities for deduction under said section. The income-tax authority notify a fund or institution only when it fulfils the following conditions as specified under section 80G(5).

One of the conditions is that such a fund or institution should maintain the regular books of accounts.

Implication of Non-Maintenance of Books of Account

The Finance Act, 2022 inserted Section 13(10) and 13(11) with effect from the assessment year 2022-23 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 expenditure incurred for the objects of the institution as specified in this section.

The newly inserted section provides that the income chargeable to tax shall be computed after allowing the deduction for the expenditure (other than capital expenditure) incurred in India for the objects of the trust or institution, subject to fulfilment of the following conditions, namely:

(a) Such expenditure is not from the corpus standing to the credit of such trust or institution as on the last day of the financial year immediately preceding the previous year relevant to the assessment year for which the income is being computed;

(b) Such expenditure is not from any loan or borrowing;

(c) Claim of depreciation is not in respect of an asset, acquisition of which has been claimed as an application of income in the same or any other previous year; and

(d) Such expenditure is not in the form of any contribution or donation to any person.

The provisions of Section 40(a)(ia), Section 40A(3) and Section (3A) shall, *mutatis mutandis*, apply as they apply in computing the income chargeable under the head "Profits and gains of business or profession". Therefore, the disallowances shall be made for the cash payment of expenditure and non-deduction or non-payment of TDS on the sum payable to a resident.

Further, no deduction of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any other provision of the Act.

Method of Accounting

There are two methods i.e. a mercantile system of Accounting or a Cash system of accounting. Assessee having income taxable under the head 'Profit & gains of business or profession' or 'Income under the head other sources' have the option to follow either cash system or mercantile system.

Under the mercantile accounting system, the net profit or loss is calculated after taking into account all the income and the expenditure relating to the period whether such income has been actually received or not and whether such expenditure has been actually paid or not. Thus, the profit computed under the system is the profit actually earned, though not necessarily realized in cash, or the loss computed under this system is the loss actually sustained, though not necessarily paid in cash.

According to the cash basis of accounting, a record is kept of actual receipts and actual payments, entries are made only when money is actually collected or disbursed.

An assessee may employ different methods of accounting for different sources of income. If such different methods are employed regularly and consistently the profits have to be computed in accordance with the respective methods, provided it results in a proper determination of true profits.

Which method of accounting is to be opted for by NGOs?

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. Therefore, the income is not to be computed under the head profits & gains from business and profession and other sources. Hence, the method of accounting suggested under Section 145 shall not apply to NGOs.

However, under the amended Income Tax laws, the method of accounting is largely on cash basis except for exceptions such as certain income accrued but not received as specified under explanation section 11(1).

The Finance Act, 2022 has inserted a new explanation after sub-section (7) of Section 11, as a result application will be allowed only on cash basis and all expenses also have to be on cash basis except some exceptions such as depreciation (being a non cash expenditure), which will be permissible as application of income subject to the provision of section 11(6).

Some specific provisions referring to cash basis of accounting under the Income Tax Act are as under:

(a) ***Voluntary contributions shall be accounted for when received:*** Section 11 and Section 12(1) use the word 'received' as against the word 'derived'. Therefore, income including voluntary contributions should always be treated as income on a receipt basis while preparing computation of income under the Income Tax Act.

(b) ***Application of Income allowed on payment basis:*** The Finance Act, 2022 inserted the following Explanation after sub-section (7) of Section 11-

> *"Explanation.--For the purposes of this section, any sum payable by any trust or institution shall be considered as application of income in the previous year in which such sum is actually paid by it (irrespective of the previous year in which the liability to pay such sum was incurred by the trust or institution according to the method of accounting regularly employed by it):*
>
> *Provided that where during any previous year, any sum has been claimed to have been applied by the trust or institution, such sum shall not be allowed as application in any subsequent previous year."*

This Explanation explicitly provides that any sum payable by any trust shall be considered as application of income in the previous year in which such sum is actually paid. Thus, the application of income shall be allowed only on a payment basis.

This is irrespective of the previous year in which the liability to pay such sum was incurred by such trust according to the method of accounting regularly employed.

A proviso to the Explanation further provides that where any sum has been claimed to have been applied by such trust during any previous year, such sum shall not be allowed as an application in any subsequent previous year.

These amendments will take effect from 1st April, 2022 and will, accordingly, apply in relation to the assessment year 2022-2023 and subsequent assessment years.

(c) **Deemed Application:** 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.

Applicability of Accounting Standards on NGOs

Accounting Standards are designed to apply to the general purpose financial statements and other financial reporting, which are subject to the attest function of the members of the ICAI. Accounting Standards formulated by the ICAI do not apply to an NPO if no part of the activity of such entity is commercial, industrial or business in nature.

The accounting standards would apply even if a very small proportion of activities is considered to be commercial, industrial or business in nature.

For example, If an NPO is engaged in the commercial activity of granting loans/credit to small entrepreneurs at nominal rates of interest or in the industrial activity of manufacturing clothes for the rural poor, Accounting Standards formulated by the ICAI would apply to such an NPO.

Recommendation of ICAI on the applicability of Accounting Standards

Since the Accounting Standards contain wholesome principles of accounting, these principles provide the most appropriate guidance even in the case of those organizations to which Accounting Standards do not apply.

It is, therefore, recommended that all NPOs, irrespective of the fact that no part of the activities is commercial, industrial or business in nature, should follow Accounting Standards.

Thus, following the Accounting Standards laid down by ICAI would help NPOs to maintain uniformity in the presentation of financial statements, proper disclosure and transparency.

Applicability of ICDS on NGOs

The CBDT has notified Income Computation and Disclosures Standards (ICDS) for the computation of taxable income. Till date, 10 ICDS have been notified which are applicable from Assessment Year 2017-18. ICDS are applicable only for the computation of taxable income and not for the maintenance of books of account.

In exercise of the powers conferred by Section 145(2) of the Income Tax Act, 1961, the Central Government has notified the Income Computation and Disclosure Standards. ICDSs have been issued to bring uniformity in the accounting policies and provisions of the Income Tax Act and to reduce the litigations.

Every assessee earning income taxable under the head 'Profit and gains from business or profession' or 'Income from other sources' or both is required to compute taxable income in accordance with notified ICDS. However, the ICDS shall be followed only if the assessee is maintaining accounts as per the 'Mercantile system' of accounting.

ICDSs have to be applied for the purpose of computation of business income only and an assessee is not required to maintain books of accounts as per these standards. In the event of a conflict between the provisions of the Act or Rules and ICDS, the provisions of the Act or Rule, as the case may be, shall prevail over ICDS.

Since the five heads of income do not apply to NGOs, the ICDS shall not apply to NGOs for the computation of income under Sections 11 and 12.

Thus, ICDS shall apply to a charitable/ religious organization when taxed as a normal assessee under five heads of income, i.e. if section 12AB registration is withdrawn or not registered under such provision. Since when it is not registered under section 12AB, it will be taxed based on income computed under five heads of income.

Legal and Accounting Treatment of Depreciation & Types of Assets

Understanding Depreciation

Depreciation is again one of the most important accounting aspect which has to be understood properly. It normally implies, the loss in the value of assets due to wear and tear and efflux of time. To understand this concept, let us go back to our illustration of "Nimhas" who had purchased few assets for his NPO but did not understand the accounting concepts.

Nimhas is an established social activist and he has been working for more than a year. After one year of operations, Nimhas was just making a common sense analysis of his financial status. He found that he had purchased various fixed assets such as Building, Vehicle, Furniture, Office Stationery, Electrical Equipments etc. On physical inspection, he saw that these assets were not looking as good as they looked a year ago, constant use had taken a toll over these assets. However, his Books of Account were showing them at the price at which they were purchased. He realistically felt that neither the assets were as good as they were on purchase nor would they realise the same amount if he tried to sell them. Therefore, he felt that though no money had flowed out of the organisation, there was certainly a loss in the value of the assets he possessed and therefore he frantically tried to make some accounting adjustment. Then he was told that what he had noticed was a normal business phenomenon and what he thinks as the loss in the value of asset is known as ***Depreciation*** in the accounting language.

The basis and quantum of charging depreciation depends on the nature of the asset, its original cost, estimated useful life and residual scrap value at the end of the working life. Depreciation is normally charged either on ***straight line method or written down value method.*** Under straight line method, the original cost less the residual value at the end of the life of the asset is divided by the number of years of useful life and apportioned equally among the years. Under written down value method, a fixed percentage is written off on the diminishing balance of the asset annually. Normally, depreciation is charged on all the assets including those purchased during the year for full year. Similarly, depreciation should not be charged on assets sold/ discarded/ written off during the year. However, w.e.f. 1-4-1998 as per Section 32(1) of the Income Tax Act, 1961, if the asset is acquired by the assessee during the previous year and is put to use for a period of less than one hundred and eighty days in that previous year, the deduction in respect of such asset shall be restricted to fifty percent of the amount of depreciation calculated for an asset. In other words, to claim depreciation for the

complete year, the assets must have been used for at least six months in a year.

Purchase of Assets Allowed as Application

In case of NPOs, if project assets are purchased from the current year's income then the entire amount is treated as valid application of fund. In such circumstances, it becomes difficult to charge further depreciation as the value of the assets is reduced to nil by treating them as application of fund in the Income and Expenditure Account.

It is advisable that the assets (which are written off in the year of purchase) should be reflected in the Balance Sheet at their normal value by creating an Asset Fund on the liability side of the Balance Sheet. Every year both the Asset Fund on the Liability side and the asset on the Asset side are reduced to the extent of depreciation, to provide a true and fair view of the assets. Otherwise, such assets can also be reflected at a token value.

Types of Assets in Case of NPOs

In case of NPOs, the calculation and charge of depreciation will depend on the type of assets. Unlike commercial organisations in an NPO, assets for the purposes of depreciation can be divided into various categories.

It may be noted that if assets are purchased towards charitable purposes and project work, then they are also treated as expenditure/ application of funds. The implication of such treatment is that the assets become of zero value at the end of the year. Therefore, it becomes important to reinstate such assets in the balance sheet by creating an asset fund on the liability side.

If the asset is purchased as an investment from past or present fund then it cannot be treated as application against current year's income.

Therefore, both the source and purpose of an asset could be different in case of an NPO and therefore, the treatment of depreciation will also vary. For example, the following possibilities are there with regard to purchase of assets and its depreciation:

i) Assets purchased out of general fund, corpus fund and other free reserves of the trust. In this case, depreciation shall be charged normally as the asset is not charged to the Income and Expenditure Account.

ii) Corpus Assets purchased out of current years income and voluntary contributions which are available at the discretion of the trust. When a corpus asset is purchased or the NPO invests in an asset then it cannot be treated as application of fund. Therefore, depreciation shall be provided normally as the asset will remain in the books at cost, subject to depreciation.

iii) Project Assets purchased out of current years income and voluntary contributions which are available at the discretion of the trust. Project assets purchased are treated as expenditure/ application of income.

Therefore, the entire amount is charged to the Income and Expenditure Account and the asset value is reduced to Nil. Therefore, normally further depreciation is not charged. The assets are shown at full value in the first year by creating an asset fund on the Liability side. Both the asset fund and assets are reduced in subsequent years to the extent of depreciation. In this context, it may be noted that there are case laws where depreciation has been allowed over and above the 100% charge in the first year. In other words, 200% depreciation is allowed over the life of the asset.

iv) Assets purchased out of restricted grants received specifically for the purchase of assets. In such cases when the assets are shown as utilised and charged to the restricted fund then the assets are shown at full value in the first year by creating an asset fund on the Liability side. Both the asset fund and assets are reduced in subsequent years to the extent of depreciation. It may be noted that a restricted grant is not treated as income therefore, the asset is not shown as expenditure in the income and expenditure account.

Depreciation as a Valid Deduction Before or After Determining Income Available

The income of charitable organisations is required to be computed as per the normal commercial principles and the rules of accountancy. It is being debated whether the amount of depreciation is required to be deducted first in order to arrive at the income available for application for charitable and religious purposes. Various Courts have held that depreciation is nothing but decrease in value of property through wear, deterioration or obsolescence and allowance is made for this purpose in book keeping, accountancy. If depreciation is not allowed as a necessary deduction for computing the income from the charitable institutions, then there is no way to preserve the corpus of the trust for deriving the income. In case of NPOs, the income should be the income in the real sense which can be applied to charitable purposes and from which surplus can arise if a part thereof is not applied to the objects of the trust. Viewed from this angle, it can be said that the deduction of depreciation is not only prudent but also essential for the purpose of arriving at income available for distribution for application to charity and the amount of depreciation was not the income available for application with the assessee. The relevant case is *CIT v. Society of the Sisters of St. Anne* [1984] 146 ITR 28 (Kar.).

Depreciation Rates and Application of Section 32

It has been clarified by the CBDT as well as in various cases that the income of a charitable trust is not required to be computed in accordance with the provisions of the Act. It should be computed in accordance with the normal rules of accountancy in commercial sense. Therefore, the heads of income under section 14 and the depreciation rates provided under the Income-tax laws should not necessarily apply to a charitable or religious organisation. In *CIT. v. Sheth Manilal Ranchhoddas Vishram Bhavan Trust* [1992] 198 ITR 598 (Guj.), the following issues were placed before the High Court:

"1. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that while computing income under section 11(1)(a) of the Income Tax Act, 1961, depreciation has to be allowed?

2. Whether the Tribunal was right in law in holding that having regard to the scheme of the Act, 'income' referred to in section11(1)(a) of the Act is to be computed not in accordance with the provisions of the Act but in accordance with the normal rules of accountancy under which the depreciation has to be allowed while computing such income under section 11(1)(a)of the Act?"(p.599)

The Court held that the amount of depreciation debited to the accounts of the charitable institution had to be deducted to arrive at the income available for application to charitable and religious purposes. It further observed that the income from the properties held under trust would have to be arrived at in the normal commercial manner without classification under the various heads set out in section 14. It held that the expression 'income' had to be understood in the popular or general sense and not in the sense in which the income was arrived at for the purpose of assessment to tax by application of some artificial provisions either giving or denying deduction and, therefore, there was no reason why depreciation should not be allowed as deduction in order to determine the real income of the organisation.

In *CIT v. Institute of Banking* [2003] 264 ITR 110 (Bom.) the Court held that the provisions of section 32 were not relevant for charitable organisations. Therefore, the conditions specified in section 34 were also not applicable and the assessee was entitled to depreciation, which could be considered as legitimate in order to compute the real income of the assessee on commercial principles. Therefore, it is not necessary to strictly apply the provisions of section 32 or the rate of depreciation provided under the Act. However, there is nothing which prevents the organisation from applying the same rates or the provisions under normal commercial principle in a realistic sense.

Depreciation Where the Cost of Acquisition is Nil

It has been confirmed by the Bombay High Court in *CIT v. Institute of Banking Personnel Selection (IBPS)* [2003] 264 ITR 110/131 Taxman 386 that depreciation has to be allowed on assets received as contribution without any cost. The Bombay High Court relied on the decision in *DIT (Exemption) v. Framjee Cawasjee Institute* [1993] 109 CTR (Bom.) 463, where it was held that the Tribunal was justified in law in directing the Assessing Officer to allow depreciation on assets received on transfer, when the assessee had not incurred the cost of acquiring the assets.

Amendment in the Income Tax Act Regarding Depreciation

The Income Tax Act was amended by the Finance (No.2) Act, 2014, w.e.f. 1-4-2015 and a new sub - section(6) was inserted with regard to depreciation. After the amendment, depreciation shall be available only on those assets which were not

claimed as capital expenditure in earlier or current year(s).

In other words, NPOs should maintain separate records for:

(i) assets created out of income i.e. charged 100% to the Income and Expenditure Account in the year of acquisition,

(ii) assets created out of sources other than income. Only the assets created out of sources other than income shall be eligible for depreciation. The text of the section 11(6) is as under:

"(6) In this section where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an application of income under this section in the same or any other previous year."

It may be noted that the above section shall apply only w.e.f. 01.04.2015. The Supreme Court of India in the case *Commissioner of Income-tax v. Karnataka Reddy Janasangha* [2017] 80 taxmann.com 171(SC) held that section 11 (6) inserted by Finance Act No. 2/2014 pertaining to depreciation would apply from assessment year 2015-16 onwards.

Depreciation on House Property - Income from House Property

The income from house property is not required to be computed under the head "Income from house property", therefore, the provisions of sections 22 to 25 shall not apply. Therefore, the income from house property should be computed on commercial basis as per normal rules of accounting where depreciation should also be allowed in determining the real income. In the case of *CIT v. Society of the Sisters of St. Anne* [1984] 146 ITR 28 (Kar.), it was held that depreciation allowance in respect of the trust property would be allowed. Also not withstanding the revenue's contention to the contrary, there is nothing in section 11 which debars a charitable institution from maintaining accounts on mercantile basis. That apart, if depreciation is not allowed as a necessary deduction for computing the income of the charitable institutions, then there is no way to preserve the corpus of the trust for deriving the income. Similar views were taken in the case of *CIT v. Bhoruka Public Welfare Trust* [1999] 240 ITR 513 (Cal.).

Summing Up Notes:

- Depreciation has to be charged on all the assets. There are two methods of charging depreciation - Straight Line method and Written down value method.

- In case of project assets, the entire amount is allowed as deduction in the year of purchase.

Understanding Board Processes

Statutory or De Jure Overview of Governance

Technical Overview of Governance in an NPO

Adrian Cadbury Committee Report1 defined governance as a system which directs and controls an organisation. An NPO is an artificial legal person and therefore, it is governed by various groups of people having a very clearly defined role to play.

All registered voluntary organisations are a distinct legal entity and therefore an artificial legal person. It may be noted that a trust is not considered as legal person under the general law and the trustees collectively are recognized. However, for income tax and FCRA purposes a trust is also considered as a legal entity. The legal status of an organisation comes with legal obligations such as:

i. Statutory audit of accounts,

ii. General & Board Meetings,

iii. Filing of Returns,

iv. Adhering to the Bye-laws/ MOA/ AOA/ Trust deed,

v. Area of operation,

vi. Election of office bearers etc.,

vii. Working only for the definite objectives.

The above mentioned are some of the de jure aspects of the governance system of a voluntary organisation. An organisation has to complement and add upon these aspects to build a sound governance system, keeping in view the size and the nature of the activities. The flow chart on the next page depicts an overall picture of various person/ committees which go on to build an effective governance system.

All NPOs are accountable to the laws under which they are enacted and avail subsequent registration. Some of such statutes in India are:

i. Societies Registration Act, 1860 (along with state enactment),

ii. The Companies Act, 2013 (for Section 8 company),

iii. Income Tax Act, 1961,

iv. Foreign Contribution Regulation Act, 2010,

v. Various others statues as and when applicable.

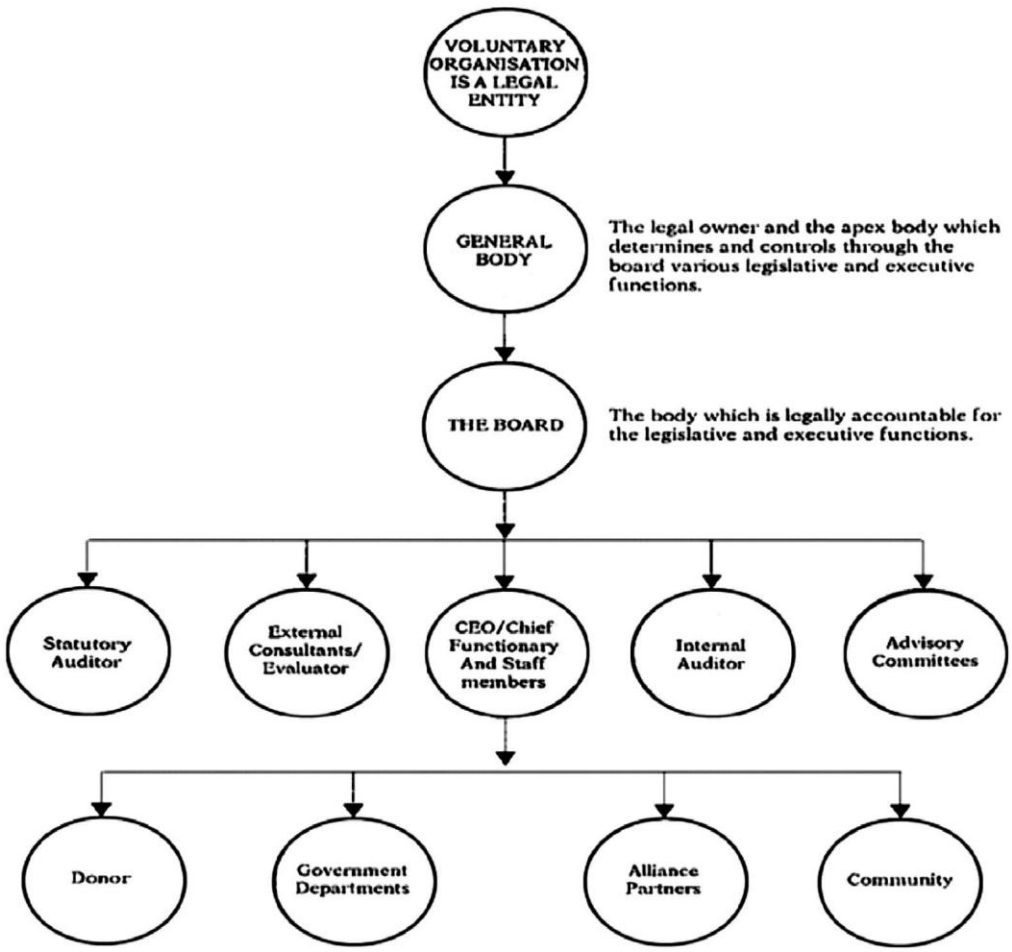
[1]In 1992 Adrian Cadbury Committee submitted a report on Corporate Governance and the social responsibilities of corporate organisations. In this report, the issue of effective and fair governance was raised internationally. Consequently, raising the quality and standards of corporate governance has been taken as a very, serious issue throughout the world and lot of legal and managerial changes have come in order to ensure that the governance of an organisations is just and fair to all stakeholders. In the NPO sector similar efforts for reform are also underway.

Flow Chart Showing the Organisational Structure

A flow chart showing the organizational structure is provided in diagram 2.

DIAGRAM 2

FLOW CHART SHOWING THE ORGANISATIONAL STRUCTURE



General Body and Its Importance

General Body is the ultimate body which regulates and controls the entity through the Board. A General Body is like the people of a democratic country who can determine or replace the parliament, but cannot assume the functions of the parliament. General Body constitutes and reconstitutes the Board and keeps control over certain statutory issues and key functions of the Board. Major legislative and statutory decisions are taken by the General Body, however, all key issues are normally recommended by the Board for the approval of the General Body.

Important and statutory nature decisions are taken at the General Body level. Some of such decisions could be as under:

i. Appointment of Auditor

ii. Election of Office Bearers

iii. Amendment of bye-laws

iv. Purchase of large properties, etc.

v. Approval of Annual Activity Report

vi. Such other decision as may be provided in the Memorandum of Association

The general members play a very effective role in the governance of an organisation. A large and empowered General Body can only ensure that the organisation functions on democratic principles. Many organisations have a very small General Body or even a co-terminus committee i.e. both the Board and the General Body comprise same set of persons. Such organisations do not reflect sound democratic structure of governance.

General Members

The NPOs registered under the Societies Registration Act or under the Companies Act or any other law which prescribes both the General Body and the Board, should ensure that there is a transparent & appropriate policy regarding general members and general meetings.

The General Body should be the body of general members with equal voting rights.The membership should be open to all section of stakeholders. The size of the General Body is determined by the nature of NPOs work e.g. generally movement based NPOs have larger General Body. However, normally the size of General Body should vary between 15 to 50 members. The General Body should always be larger than the Board, ideally 3 times or more the size of the Board.

Legislative & Executive Functions

A legislative body or function generally pertains to something legal or statutory in nature. In a country, the parliament is the legislative body and the bureaucracy generally implements or executes the legislations passed by the parliament. However, in context of an NPO, an legislative body does not imply creating statutory legislations which in any case are binding on everybody. The legislative functions imply creating legislations and policies for the organisations which may or may not be statutorily required by the law of the land. Some legislative documents of an NPO are:

- Memorandum of Association
- Articles of Association
- Various Policy Documents
- Various Resolutions passed by the General Body and Board etc.

The General Body is the highest body for legislative decisions and the Board is the highest body for executive decision making. However, for all practical purposes, both the Board & Executive decision making body functions are held by the Board, though certain key and statutory legislative decisions are approved by the general members only. The legislative functions cannot be delegated, they include:

- Legal compliances
- Custodian of assets and functions
- Amendment and Compliance with the stated Memorandum of Association, Trust Deed etc.
- Compliance with the stated Articles of Association, By-laws etc.
- Laying down policies and norms of execution.

The Board is also responsible for effective and optimum execution of all the activities and responsibilities of the NPO. Normally, the management team headed by the CEO is delegated the executive functions. The Board plays an oversight role in the execution. The Board delegates the executive functions depending on the size of the NPO and operations. In very small organisations, the Board may play a more proactive role in the execution/ implementation. However, it is generally expected that the Board should play the role of controlling and directing the various activities and processes without itself being involved in the direct execution.

Grievance & Judicial Function

The governance structure, as per the incorporation law, provides the legislative and executive powers to the Board. However, inherently the Board also possesses judicial or conflict resolution powers which are generally not very well articulated in the statute or bye laws.

All accountable NPOs should have a conflict resolution and grievance mechanism within the organisation. It could be through constitution of 'grievance committees'. However, it has to be ensured that all employees and stakeholders have an equal opportunity before such committees. For example, if the complaints are against the CEO or any Board member then there should be a mechanism in place to ensure a fair trial to the complainant.

Closely & Widely Held NPO

When an organisation has a Board of less than 7 members and General Body of less than 12 members for long periods (say 7 years), it can be considered as a closely held organisation. A closely held organisation is legally permissible. However, such structures are generally created when a corporate, family or group of people create an NPO for public purposes from their internal properties and funds. An NPO which accesses donations and grants from organisations and public at large should not be closely held by a small group of people.

Executive Leadership & Legislative Leadership

A good governance structure should maintain a clear distinction between executive leadership and legislative leadership. The examples of such distinctions are:

- The Chairman should not be the Executive Director or CEO,
- The employees should not have an influencing impact on the Board decision making.

Difference between a CEO & General Secretary

A General Secretary of an NPO is the legal representative of the Board as far as its legislative functions are concerned. The General Secretary may or may not retain the executive functions. A CEO is the highest executive position and it does not possess legislative powers.

The General Secretary is an integral part of the Board of an NPO. A CEO may or may not be provided an ex-officio position on the Board as the representative of the employees responsible for execution and implementation.

Advisory Committees

The Board is normally supported by advisory committees which consist of members possessing specialized expertise and mandate. An organisation may have, for example, committees on finance, purchase, specific program, etc. Certain NPOs also have advisory Boards which are independent and external.

The Board & Its Importance

The Board happens to be the de jure most powerful body of an organisation and in the absence of an effective Board, it is very difficult to ensure good governance in any organisation. The Board is legally accountable for the legislative and executive functions. The Board is responsible for determining all the policies, systems and processes. The Board is also responsible for the safe guard and optimum utilization of the funds, assets and resources. All decisions of enduring nature are taken at the Board level and the Board delegate's authority and responsibilities to the CEO and other managerial persons.

Broad Functions of the Board

The following are the broad functions of the board of an organisation:

- Being the employer,
- Formulating & Monitoring the Governance Structure,
- Formulating Policies,
- Securing & Safeguarding Resources,
- Being the Final Point of Accountability,
- Being a link between External Stakeholders And Environment,
- Ensuring Legal compliances and other contractual obligations.

Roles & Responsibilities of Board

The Board should formulate the mission statement & strategic plan of the organisation and should revisit periodically in order to ensure that the programs and resources are in consonance with them.

The Board should formulate the structure of authority and responsibility to be delegated to the CEO and other staff.

The Board should determine the procedure of electing/selecting the CEO and the compensation thereof.

The Board should formulate important policy documents and guidelines on gender, human resource, finance etc.

The Board should appoint the statutory auditor and the internal auditor, if required. Both the auditors should directly report to the Board. The appointment of statutory auditor should be finally approved by General Body on recommendation of the Board.

The Board should determine and approve the annual budget and allocations.

The Board should determine and approve the bank accounts to be operated and the signatories there of.

The Board should develop proper policy and systems regarding the title, safeguard, location and verification of fixed assets.

The Board should ensure strict adherence with all statutory compliances. It should also ensure that requirements/ obligations towards other stakeholders is diligently done.

The Board should constitute Advisory Committees for special functions or for specific purposes.

The Board should review the performance of the CEO and other senior management staff on annual basis.

The Board should prepare a position paper every three years on issues such as:

(i) Resource Mobilization,

(ii) Financial and Institutional Sustainability,

(iii) Programmatic relevance, reach and impact, and

(iv) Risk and contingencies.

The Board should carefully position its involvement in the management of the affairs of the organisation. Generally, the Board should not be interfering in nature, however, certain powers of approval should be retained by the Board depending on the size of the NPO. A suggested list of the additional functions of Board could be as under:

- Approval of projects and activities to be undertaken,
- Periodical perusal of the reports from the Secretary/CEO and other key functionaries,
- Approval of purchase of assets for large financial transactions,
- Approval of project budgets and investments,
- Finalizing annual financial statements,
- Staff capacity building measures,
- Appointment of staff,
- Internal control measures,
- Resource mobilization etc,
- Control over admin. expenses,
- Corpus and institutional sustainability.

Composition of the Board

The Board should be ideally between 5 to 13 members unless the legal requirements are different.

The Board should, normally, not have members who are permanent in nature except the case of institutional nomination.

In case of a trust, normally a clause regarding permanent trustees is found. In such instances, it is desirable that the total voting right of the founder trustees is less than 50%.

The composition of the Board should be clearly defined in terms of the diversity of the skills required for discharge of the Board functions. The balance of the Board should be maintained in terms of gender, finance & other specialized skills, stakeholders, distance & availability.

Presence of Employees on the Board

Not more than 2-3 employees should be Board members with voting rights or at any point, the employees' participation should not exceed 40-50% of the Board members. If two or more employees are on the Board then they should not be relatives. The main issue is to keep the Board independent of the executive functions. If people involved in execution and implementation are dominating the Board, then the Board shall cease to be an independent body.

In the context of the issue of employees on Board, it is generally misunderstood with participation of employees on Board as a stakeholder. However, this issue is much larger than inviting representatives from the employee fraternity on Board. This issue is about the presence of members who are compensated for the services rendered on whole time basis. Such members could be:

- Representatives of employees who become Board member by virtue of being an employee.
- Elected Board members who are in whole time service in terms of the bye laws.
- Pre-defined executive heads like CEO or ED who find an ex-officio position in the Board.

One or more of the above circumstances may be relevant depending on the bye laws and governance structure of the organisation.

It may be noted that the sum total of all such Board members should not have any material influence on the decision making of the Board. Further, there should be a clear & written policy on conflict of interest where trustees and staff (or any stakeholder) are involved.

Election/Selection of the Board Members

There should be a clearly defined policy for recruitment, election, selection of trustees or Board members. The induction of new trustees should be through an open process providing the opportunity of being elected/ selected to a wider group of stakeholders. The process should include use of methodologies such as advertising for new trustees through various medium.

The Board members should retire and be re-elected on the basis of rotation. For instance, every two years a third of the Board can retire. Though the Board members usually get re-elected but the technical possibility of replacing the entire Board in an election process should be avoided.

Board Processes

There should be a process for orienting and sensitizing of the trustees regarding their responsibilities in particular as well as in general.

There should be a process through which clear distinction between strategic matters and operational matters should be made and a position paper should be drafted and revisited annually.

The Board should set key performance indicators for themselves.

The Board should, ideally, meet once in every quarter, However, it is recommended that the Board should meet at least twice in a year i.e. once in every six months.

An annual report on the participation and other contributions of the Board members should be prepared to assess the stakes and ownership of the Board members.

Permanent or Long Term Board Members

As discussed earlier, organisations should not have a majority of long term or permanent Board members unless it is privately funded.

The name and percentage of trustees or Board members who have served for more than 15 years on the Board either continuously or through intermittent tenures should be separately declared.

CEO and Management Staff

The CEO and staff members are responsible for the day to day management of the organisation. The CEO happens to be the focal point around which the entire organisation revolves. He is the executive head of the organisation.

The CEO generally does not possess legislative powers. The CEO interacts with most of the stakeholders such as donors, alliance partners, communities and also with the Board etc.

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.

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.

Independent Directors

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. One of the ways of keeping the independence of the Board is to have a well -articulated 'conflict of interest' policy.

Ex-Officio Board Members

The memorandum of association of the society can be suitably drafted so as to have provision regarding Ex-officio Board members. An Ex-officio Board member denotes the right of a particular formal position holder to participate and vote in the Board proceedings. For instance, an NPO may provide that the District Magistrate will be one of the Board members, then who ever is the District Magistrate will automatically have the right of a normal Board member.

Different Traits or Types of Board

All NPOs are created by people for human intervention in public causes. Therefore, each NPO and its board are distinct and unique. The boards of NPOs consciously or unconsciously take different forms and assume different attributes which may or may not serve the purpose of the organisation. In this chapter, we will discuss the various peculiarities of board structures and the de facto reality of various boards and trustees, based on our study, experience and understanding.

Board Formed in 'Fiduciary' Capacity or Under Trusteeship

The Trust form of registration was legislated for NPOs formed in fiduciary capacity or under trusteeship. In such model, an individual or entity bequeaths its property or wealth for public purposes and appoints a group of person as trustees. Some attributes of such board are as under:

- Appointment of board or trustee is discretionary in nature, at the hand of the settler,
- Boards of trustee are more like a guardian for an orphan child.
- Boards are closely held bodies and they work on the principle of loyalty towards the settler of the trust. They work towards fulfilling the promise which they give by becoming trustees.
- Boards have a top down orientation where the trustees work on a pre-determined mandate.

Such fiduciary boards are good for specific trusts but such models have severe limitations when they start working on resources generated from society at large. Further, the long term institutional sustainability and transition of leadership always remains a matter of concern in such models.

Family or Founders Board

There are organisations including trust and society which are created by a particular family or an individual. In such organisation, the board and governance is basically controlled by one family or an individual. Some peculiarities of such model are as under:

- Such organisation has a board which comprises friends and relatives.
- The board of such organisation some times may have eminent people from the society, who normally do not give time or interfere.
- Such organisation normally becomes successful on the basis of the charisma, expertise or contacts of one individual or a family.
- Such organizations are prone to misuse of resources and power by the board members.
- In such organisations, empowerment of staff and democratic decision making become difficult.
- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

Founding Members Board

There are organizations including trust and society which are created by a particular group of individuals who may have common goal and vision for public purposes. In such organizations, the board and governance is basically controlled by the founding members. Some peculiarities of such model are as under:

- Such organizations have a board which comprises the founding group of

members and their friends & relatives.

- The board of such organisation some times may have eminent people from the society, who normally do not give time or interfere.

- Such organizations normally become successful on the basis of the charisma, expertise or contacts of the founding group of members.

- Such organizations sometimes turn out to the very effective in terms of governance and programmatic relevance. However, such effectiveness is dependent on the individual commitment of the founding members. From a systemic point of view, such models do not reflect shared ownership of all the stakeholders.

- Such organizations are prone to infighting and power struggle within the board members.

- Such organizations are prone to misuse of resources and power by the board members.

- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

CEO's Board

There are organisations including trust and society which are controlled by the CEO or the Executive Director. Such organisations generally have a strong historical precedence and are generally created by formal institutions for specific or a larger cause. For instance, an Association of NPOs may be registered for a purpose or a donor may support in creation of an organisation for definite public purposes. The board and governance is basically controlled by the management and the executive head of the organisation. In such an organisation, the board is initially identified by the founding institutions and later on, it may be based on ex-officio position or rotation of eminent people of the society. Some peculiarities of such model are as under:

- Such organizations have a board which comprises of eminent people from the society who are invited to oversee the governance process.

- The members of board of such organizations are scattered and sometimes are ex-officio positions. Further, the CEO of the organisation is relatively stable and the board may keep on changing. Therefore, the board may lack a strong sense of ownership and authority over the management.

- Such organizations normally become successful on the basis of the charisma and expertise or contacts of the Executive Director or the CEO.

- Such organizations sometimes turn out to the very effective in terms of governance and programmatic relevance. However, such effectiveness is dependent on the individual commitment of the CEO or Executive Director. From a systemic point of view, such models do not reflect shared ownership of all the stakeholders.

- In such organizations, the board sometimes becomes an ineffective formal structure which mostly relies on the inputs and directions provided by the CEO or Executive Director.

- Such organizations do not have a healthy governance structure as the staff and management become more powerful than the board.

- Such organizations are prone to misuse of resources and power by the CEO or Executive Director. Therefore, such organizations are strongly dependent on the charisma and values of the CEO or Executive Director.

- In such organizations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

Token Board

There are organizations including trust and society which are created for public purposes but the board and governance is basically controlled by people other than the actual board members.

Case Study: An NPO claimed that 100% of its board members were women from the target communities. However, in reality, all these board members depended on the management of the organisation, they were basically used to create an illusion of an accountable and participative model of governance. On verification of records, it was found that the board members were entitled for bus fares and very modest accommodation in contrast to the entitlement of the staff that were entitled for travel by Air and accommodation in three star hotels. There were many other findings which made it apparent that the board members were marginalized beneficiaries only. Some peculiarities of such model are as under:

- Such organisations have a board which comprises representatives from the target community.

- The members of board of such organisations stay away from the actual functioning of the organisation and are invited only twice or thrice in a year. Further, the CEO of the organisation is relatively stable and the board may keep on changing. Therefore, the board lack a sense of ownership and authority over the management.

- The board members depend on the CEO and management for various program and entitlements which is a strong deterrent to their empowerment.

- Such organisations have a camouflaged board and from a systemic point of view, such models do not reflect shared ownership of all the stakeholders.

- In such organisations, the board in an ineffective formal structure which mostly relies on the inputs and directions provided by the CEO or Executive Director.

- Such organisations do not have a healthy governance structure as the staff and management become more powerful than the board.

- Such organisations are prone to misuse of resources and power by the CEO or Executive Director.

- In such organisations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

Interested Party Board

In corporate governance, it is provided that all companies should have independent directors. However, in case of NPOs, each and every director is supposed to be independent i.e. they should not have any personal interest in the resources or functioning of an NPO. However, the directors in an NPO are permitted to take reasonable remuneration and payment against any other goods and services rendered. In an NPO, if majority of the directors are taking remuneration, consultancy or have rented their premises etc., then such board is called an interested party board as most of the board members are dependent on the NPO for some monetary consideration (even if it is legitimate) which may impair their ability to govern. Some peculiarities of such model are as under:

- Such organisations have a board which comprises people who are involved in the day to day activity.

- The board of such organisations depend on the organisation for earning income for their personal purposes, therefore, if the number of such board members exceed more than 50% of the total board then the board does not remain independent.

- Such organisations, sometimes, turn out to be the very effective in terms of governance and programmatic relevance. However, from a systemic point of view, such models have little distinction between the management and the board.

- Such organisations are prone to compromises between the management and the board as both have individual interest at stake.

- Such organisations are prone to ineffective or misuse of resources and power by the board members.

- In such organisations, also, the long term institutional sustainability and transition of leadership always remains a matter of concern.

Employees Board

In case of NPOs, the directors are permitted to take reasonable remuneration and payment against any services rendered. It has been seen that sometimes most of the board members draw salaries. In an NPO, if majority the directors are taking remuneration, then such board is called an employee's board as most of the board members are dependent on the NPO for salaries (even if it is legitimate) which may impair their ability to govern. Some peculiarities of such model are as under:

- Such organisations have a board which comprises people who are involved in the day to day activity.

- The board of such organisations depend on the organisation for earning

income for their personal purposes, therefore, if the number of such board members exceed more than 50% of the total board then the board does not remain independent.

- Such organisations sometimes turn out to be the very effective in terms of governance and programmatic relevance. However, from a systemic point of view, such models have little distinction between the management and the board.

- Such organisations are prone to compromises between the management and the board as both have individual interest at stake.

- In such organisations, an effective board does not exist and therefore it can be said that the organisation is being governed by the employees.

- Employees are one of the most important stakeholders but such models of board may result in misuse of resources and power by the board members in favour of the employees.

- In such organisations, also, the long term institutional sustainability and transition of leadership always remain a matter of concern.

Ornamental or Eminent Board

Many NPOs have a board comprising of very high profile individuals. There are NPOs whose board members are the "Who's Who" of the society. Such boards are highly impressive simply because of the quality and eminence of the board members. Some peculiarities of such model are as under:

- Such organisations have a board which comprises people who are not involved in the activity of the organisation.

- The board of such organisation does not internalize the work of the organisation because such member may not have the time to be involved in the organisation.

- Such organisations may be very effective in terms of governance and programmatic relevance. However, from a systemic point of view, such models have very little de facto role of governance for the board.

- The board of such organisations is generally endorsive in nature. However, due to the quality of the people involved enduring and strategic decision are generally well taken.

- Such organisations may not have an effective board for the oversight function over the management.

- Such organisations rely heavily on the CEO and Executive Committee for the normal functioning of the organisation.

- Such boards do not reflect a true representation of the various stakeholders. Such boards should be balanced with people from other sections of stakeholders.

- In such organisations, also, the long term institutional sustainability and

transition of leadership always remains a matter of concern, as the organisation generally survives based on the executive systems.

Political Board

Many NPOs have a board comprising of individuals from cross section of stakeholders and members. There could be NPOs where the members may come from the geographical spread, for instance one board member from each district. Or a national level NPO may have state bodies as members and board members may come from each state. When the board is formed as a result of nominations/ election based on pre-determined sections whether geographical or otherwise, such board are called political boards. National association of professionals and other national bodies are examples of such NPOs. Some peculiarities of such model are as under:

- Such organisations have a board which comprises people who are not involved in the activity of the organisation at the governance level. Such people generally work at a functional or divisional level of the organisation. Therefore, the board members are prone to their individual divisional interest or the interest of the constituency they represent.

- The board of such organisation is too involved and internalizes with most of the work of the organisation because such member may be involved at various levels in the organisation.

- Such organisations may be very effective in terms of governance and programmatic relevance. However, from a systemic point of view, such models have very little de facto independence in the role of governance for the board.

- The board of such organisations is generally compromising in nature. Normally, members belonging to powerful groups and constituencies influence the decision making process.

- Such organisations may not have an effective board for the oversight function over the management. The board is involved in the execution and the CEO and the management staff may not be empowered enough.

- In such organisations, the voting power and number game becomes important and as a result, the interest of the marginal stakeholders may suffer.

- Such boards provide a true representation of the various stakeholders, however, it is difficult in such model to have independent board members who do not have any interest in the decision making process.

- In such organisations, also, the long term institutional sustainability and transition of leadership is not a matter of concern, as the organisation generally survive based on the membership and organisational structure.

Ex Officio or Nominated Board

Many NPOs have a board comprising of individuals who are nominated by various

institutions. There are NPOs whose general members are mostly institutins and various government bodies. The institutional members generally nominate members to the board. In such NPOs, the board members are the Ex-officio nominations from various institutions and government bodies. Such boards are artificial in nature as the board members get appointed only because of a position they are otherwise holding. Some peculiarities of such model are as under:

- Such organisations have a board which comprises people who are not involved in the activity of the organisation.
- The board of such organisation does not internalize with the work of the organisation because such member may not have the time to be involved in the organisation.
- Such organisations may be very effective in terms of governance and programmatic relevance. However, from a systemic point of view, such models have very little de facto role of governance for the board.
- The board of such organisations are generally endorsive in nature and the governance is largely dependent on the executive team.
- Such organisations may not have an effective board for the oversight function over the management.
- Such organisations rely heavily on the CEO and Executive Committee for the normal functioning of the organisation.
- Such boards may reflect a true representation of the various member organisations. However, such boards should be balanced with people from other sections of stakeholders.
- In such organisations, the long term institutional sustainability and transition of leadership may not be a matter of concern, as the organisation generally survives based on the membership structure and executive systems.

Overview of General and Board Meetings

Sound governance largely depends on the effective interaction between the decision-making persons of the organisations. It is very important that regular meetings are conducted for various policy matters and legislative and executive decision making. The General Members and the Board/ Trustees exercise the power entrusted to them as per the governing documents such as Trust Deed, Memorandum of Association and Articles of Association. The provisions of the statute of registration also regulate the procedure for conducting Board and General Meetings.

In an NPO, two types of meetings are normally held,

(i) General meetings,

(ii) Board meetings.

The NPOs which are formed as companies or registered under the Societies Registration Act, normally have both

General Body and the Board. But NPOs registered as trusts normally do not have a General Body and therefore the Trustees happen to be the ultimate body.

General Members' Meeting

A meeting of the General Members normally should be held at least once in a year to discuss and approve important matters like approval of audited accounts, appointment of Statutory Auditors, review of activities during the year, election of the Board Members. This meeting is called Annual General Meeting (AGM). It is normally conducted within six months from the end of the financial year and all the activities and accounts for the previous financial year are placed.

Apart from the AGM, General Meetings can also be called during the year if the circumstances demand so. All General Meetings other than the AGM are normally called as Extraordinary General Meeting (EGM) or Special General Meeting (SGM). Whether it is an Annual General Meeting or Special General Meeting, all the members of the organisation have the right to participate and vote. Therefore, all the decisions of enduring significance should be taken in a General Meeting.

Board Meetings & Its Frequency

The meeting of the Governing Body or the Board of an organisation should ideally be held at least once in every three months. The Board may meet more frequently if it is required.

A Board meeting in every quarter is not legally mandated under any central statute. Even a Section 8 Company registered under the Companies Act is permitted to have Board meeting only once in every six months. All other registered companies are required to hold Board meetings at least once in every three months and four meetings in a year. However, Section 8 Companies are exempted from the four meeting clause [vide Notification No. 466(E) Dated 5th June 2015] as they can have Board meetings only once in every six months.

The Trust Deed or Articles of Association may specifically provide for the number and procedure of Board meetings to be held during the year.

Special Invitees to the Meeting

The Board or the Trustees may invite special invitees to some of the meetings. The following issues are pertinent in this regard:

- A Board member should not send representative as special invitee.
- A special invitee may be a technical or a professional person who is invited for specific agenda items. In such cases, the special invitee should normally participate for that particular agenda item only.
- The Statutory Auditor, advisors, donor representative etc. may be invited as special invitees. Such special invitees should participate in the discussions but should not vote against or in favor of a motion.

- As a principle, special invitees should not possess any voting right and the organisation should formulate a policy regarding the role and participation of special invitees in a meeting.

Notice & Agenda for Convening General Meetings and Board Meetings

General Meetings

Authority to Convene General Meeting

The Board or the Governing Body of the NPO is the authority for convening all general meetings including the Annual General Meeting. The Board should convene a general meeting *suo moto* or on the requisition by the members. The decision for convening the general meeting should be passed in a meeting of the Board or the Governing Body or such resolution may be passed by resolution.

What If Board Fails to Convene a General Meeting?

If the Board or the Governing Body of the NPO fails to convene a general meeting even after the requisition by the members, then the members who make the requisition may call the meeting. All NPOs should have clear bye-laws regarding the circumstances where the General Members can call a general meeting through requisition.

There should be a norm of minimum number of General Members required to requisition a general meeting. The requisition should be first made to the Board or the Governing Body. If the Board or the Governing Body fails to convene a general meeting, then after a reasonable time period, the General Members themselves may issue a notice for the General Meeting.

A recommended number of General Members for requisition of general meeting could be 5 members or 20% of the total members whichever is higher. The members may wait for 30 days for convening of the meeting by the Board; thereafter they may convene the meeting by issuing a notice for 21 days.

Serving Notice of a General Meeting

A notice of every meeting is required to be given in writing. Care should be taken to provide for the length of the notice while framing the bye laws of the organisation. In the absence of any time limit of notice in the bye-law, it is desirable to give 21 days' notice for a General Meeting.

The notice of a General Meeting should be given to every member of the NPO. Such notice should also be given to the Directors/ Trustees. The notice should be given to the Statutory Auditors, in case of Annual General Meeting.

The notice should be given by hand or by post and should also be placed on the website, if any, of the NPO.

The Notice should specify the day, date, time and venue of the Meeting with complete address. Meetings should commence during working hours, on a working day, at the Registered Office of the NPO or at some other place within the city,

town or village in which the Registered Office is situated.

If the venue of the Meeting is not a prominent place, a site map of the venue should be enclosed with the Notice.

The Notice should prominently contain a statement that a Member entitled to attend and vote is entitled to appoint a Proxy to attend and vote instead of himself wherever is applicable.

Recommended Agenda for a General Meeting

A notice of every general meeting is required to be given in writing. Care should be taken to provide for the length of the notice while framing the bye laws of the organisation. In the absence of any time limit of notice in the bye-law, it is desirable to give 21 days' notice for a General Meeting and 7 days' notice for a Governing Body meeting.

Along with the notice of a meeting, it is necessary to enclose a list of items to be discussed/ resolved, such list is known as AGENDA. It is very important that the agenda of a meeting is sent in advance preferably with the notice, it helps a member to prepare for the meeting. Issue of a meticulous agenda in advance shows the transparency and democratic functioning of an organisation.

Some matters which normally may form a part of the agenda are as under:

- Reading and confirming minutes of the previous meeting.
- Any matter arising out of the previous minutes.
- Issues which were deferred in the previous meeting.
- Various specific matters planned to be discussed in the meeting.
- Any matter involving related party transactions requiring confidential or restricted decision making.
- Matters requiring special or unanimous resolutions.
- Listing out the action points.
- Appointment of Auditor.
- Election of Office Bearers etc.
- Date of next meeting and deadlines of documentation.
- Closure or adjournment of meeting.

It may be noted that any matter which requires special or unanimous resolutions should be supported with an explanatory statement along with the notice.

Board Meetings

Authority to Convene Board Meeting

The General Secretary, Executive Director, Chief Functionary, any Board Member/ Trustee or the CEO is the authority for convening all Board meetings, unless otherwise specified in the bye laws or the trust deed.

Serving Notice of a Board Meeting

A notice of every meeting is required to be given in writing. Care should be taken to provide for the length of the notice while framing the bye laws of the organisation. In the absence of any time limit of notice in the bye-law, it is desirable to give 7 days' notice for a Board Meeting.

The notice of a Board Meeting should be given to every Director/ Trustee/ Board Member of the NPO.

The notice should be given by hand or by post and should also be placed on the website, if any, of the NPO. The notice can also be sent by email or facsimile or any other electronic mode which may have been approved or specified.

The Notice should specify the day, date, time and venue of the Meeting with complete address. Meetings should commence during working hours, on a working day, at the Registered Office of the NPO or at some other place within the city, town or village in which the Registered Office is situated.

The meeting may be held in any other venue also. Further, the meeting may also be held on public holidays or Sunday's.

If the venue of the Meeting is not a prominent place, a site map of the venue should be enclosed with the Notice.

There is no need to give notice of an adjourned meeting other than a meeting that has been adjourned "sine die". However, Notice of the reconvened adjourned meeting should be given to those Directors/ Trustees who did not attend the meeting which had been adjourned.

No discussion should be made or matter should be resolved in any Board meeting if proper notice has not been served as described above.

Recommended Agenda for a Board Meeting

Along with the notice of a meeting, it is necessary to enclose a list of items to be discussed/resolved, such list is known as AGENDA. It is very important that the agenda of a meeting is sent in advance preferably with the notice. It helps a member to prepare for the meeting. Issue of a meticulous agenda in advance shows the transparency and democratic functioning of an organisation.

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- Issues which were deferred in the previous meeting.
- Various specific matters planned to be discussed in the meeting.
- Any matter involving related party transactions requiring confidential or restricted decision making.
- Matters requiring special or unanimous resolutions.

- Listing out the action points.
- Date of next meeting and deadlines of documentation.
- Closure or adjournment of meeting.

It may be noted that any matter which requires special or unanimous resolutions should be supported with an explanatory statement along with the notice.

Recommended Agenda for Quarterly Board Meetings

The Board of an organisation should perform specific task in various quarters of the year. Apart from the various mandated and discretionary functions, the Board should preferably include the following issues in the agenda for various quarters:

- In the Board meeting held during the January-March quarter, the Board should include in the agenda issues such as:
  - (i) Approving programs/ budgets of forth coming year,
  - (ii) Status of statutory compliances to be done within 31st March,
  - (iii) Major deviation in planned and actual activities.
- In the Board meeting held during the April-June quarter, the Board should include in the agenda issues such as:
  - (i) Review of the previous year,
  - (ii) Performance appraisal,
  - (iii) Pay determination for CEO/ key personnel.
  - (iv) Status of closing and finalization of accounts and reconciliations.
- In the Board meeting held during the July-September quarter, the Board should include in the agenda issues such as:
  - (i) Recommending audited accounts and annual report of previous year for the General Body for approval,
  - (ii) Nominating Directors/ Board members to be approved at AGM,
  - (iii) Recommending auditor for AGM to approve.
- In the Board meeting held during the October-December quarter, the Board should include in the agenda issues such as mid year review of programs, financials etc.

Agenda for Board Meetings Where Annual Accounts/ Activities Are Considered

The Board/ Trustees should consider various matter in specific detail in the Board meeting where annual account/ activities are considered.

Attendance, Quorum and Proxy for General and Board Meetings

Attendance at General and Board Meetings

A hard-bound attendance register should be

maintained for recording the attendance of all the eligible participants to the meeting including special invitees.

If an attendance register is maintained in loose-leaf form, it should be bound at reasonable intervals and may be destroyed after eight years, with the approval of the Board.

The attendance register in case of general meetings should contains the names, address and signatures of the members and special invite present at the Meeting.

The attendance register in case of Board meetings should contains the names and signatures of the members and special invite present at the Meeting.

Leave of Absence

In case of general meetings, normally there is no need to grant a special leave of absence for the General Members.

However, in case of Board meetings, leave of absence should be granted to a Director/ Public Trustee only when a request for such leave has been communicated to the Secretary or to the Board or to the Chairman.

Quorum

The term quorum implies the minimum number of members that must be present to make the proceedings of a meeting valid. Normally, the bye-laws of an organisation specify the quorum required for different meetings. An organisation should carefully devise the requirement of Quorum for general and Board meetings.

In case of Board meetings, if the required quorum is high (example: 50% of Board members) then it may become difficult to hold valid meetings. And if it is too low (example: 2 of Board members) then important decision may be taken without the involvement of the majority. Therefore, the bye-laws may be drafted or amended accordingly.

In case of General Meetings, even a small percentage of the quorum may prove to be very high (example: 25% of members in case of an organisation having 1000 members) then it may become difficult to hold valid meetings. And if it is too low (example: 3 of General Members) then important decision may be taken without the involvement of the majority. Therefore, the bye-laws may be drafted or amended keeping in view the size of the General Body.

If the bye laws or trust deed is silent then it is suggested that the quorum for General Meeting should be at least one third of the total members in case where the total members are less than 30. For NPOs with larger General Body, a suitable basis quorum may be fixed depending on the size and nature of the organisation.

For Board meetings, at least 33% of the Board members should be present to form the quorum. If the quorum is not present in any particular meeting then the meeting should be adjourned to a future date by the members present on that day. It is not advisable to convene a meeting without quorum on the same day after allowing an adjournment of 30 minute or 1 hour.

If on the adjourned future date, again the quorum is not present then the members present (not less than 2) should be considered as valid quorum. The future date for the adjourned meeting should ideally be within 7 to 14 days.

It may be noted that proxies are not permissible for the determination of quorum both in General and Board meeting.

Proxy

Proxy refers to a person or a representative empowered to attend a meeting on behalf of a member. Any member of an organisation who is entitled to attend and vote at meetings is also entitled to appoint a proxy who can also attend & vote. A proxy has to carry an authorization form; the member entitled to attend the meeting should authorize his/ her representative in writing in a proxy form. A proxy form should be deposited in advance at the registered office of the organisationat-least two days before the date of the meeting.

A proxy is not permissible for Board meetings and should be used in General Meetings only. Proxy should preferably be avoided in a voluntary organisation.

CSR Applicability and its Framework

Introduction

The Corporate Social Responsibility (CSR) provisions are specified under section 135 of the Companies Act, 2013. Accordingly, the CSR provisions are applicable to the Company, who satisfy any of the following conditions:

(i) Net worth of the Company is rupees five hundred crore or more, or

(ii) Turnover of the Company is rupees one thousand crore or more, or

(iii) Net profit of the Company is rupees five crore or more.

Once, any of the condition is fulfilled by the Company, then the Company needs to comply with CSR provisions from immediately succeeding financial year.

The Company needs to spend at least 2% of the average net profit earned during the immediately preceding three financial years.

1) CSR Applicability in case of Holding and Subsidiary Company

The CSR compliance is specific to each company. A holding or subsidiary of a company is not required to comply with the CSR provisions unless the holding or subsidiary Company itself fulfils the eligibility criteria prescribed under section 135(1) of the Company Act, 2013.

For Example: Company A is covered under the criteria mentioned in section 135(1) of the Company Act, 2013. Company B is a holding Company of Company A. If Company B by itself does not satisfy any of the criteria mentioned in section 135(1), Company B is not required to comply with the provisions of section 135.

2) Applicability of CSR for a Section 8 Company

The section 8 Company is a Not-for-Profit Company, registered under Companies Act, 2013. There is no specific exemption available to section 8 Company under CSR. If the Company satisfies any of the three conditions as specified under section 135(1) of the Company Act, 2013, it needs to expend the 2% of the average Net Profit earned during the immediate three financial year from its trading activities.

3) Applicability for a New Company

If a Company has not completed three financial years of its incorporation. However, it satisfies any of the criteria mentioned (net worth, turnover, or net profits) in section 135(1), of the Company Act, 2013, the CSR provisions would be applicable from the succeeding financial

Profit would be calculated for its years of presence, say for one or two preceding year or years.

4) CSR Activity and its Locations

As per the first proviso to section 135(5) of the Companies Act, 2013, the company should give preference to local areas around where it operates. However, with the advent of IT and the emergence of new-age businesses like process-outsourcing companies, e-commerce companies, and aggregator companies, it becomes difficult to determine the local area for various activities. Thus, the preference to the local area mentioned in the Act is only directory and not mandatory, and companies need to balance local area preference with national priorities.

5) Composition of the CSR Committee

The Company which satisfies the criteria of section 135(1), should constitute a CSR Committee. While constituting a CSR Committee, one should keep the composition of the CSR Committee for various categories of Companies in following manner:

Sl.	Types of Company	Composition of the CSR Committee
1.	**Listed Companies**	Three or more Directors, out of which at least one shall be an Independent Director.
2.	**Unlisted Public Companies**	Three or more Directors, out of which at least one shall be an Independent Director. However, if there is no requirement of having an independent director in the company, two or more directors.
3.	**Private Companies**	Two or more Directors. No independent Directors are required as mentioned in the proviso under section 135(1).
4.	**Foreign Company**	At least two persons out of which: (a) One person shall be resident in India and authorized to accept the service, any notice or other documents required to be served on the Company, and (b) Another shall be nominated by the Foreign Company.

The requirement CSR Committee is not mandatory for those Companies where the total CSR amount required to be spent on CSR by a Company does not exceed fifty lakh rupees. In such Company, the functions of the CSR Committee shall be discharged by the Board of Directors of that company.

6) The functions of the CSR Committee

The function of Corporate Social Responsibility Committee is to -

(i) Formulate and recommend the CSR policy to the Board;

(ii) Recommend the amount of expenditure to be incurred on CSR activities;

(iii) Monitor the CSR policy of the company from time to time; and

(iv) Formulate and recommend to the Board, an annual action plan in pursuance of its CSR policy.

7) The Function of Company's Board of Directors

It is well known that CSR is a Board-driven process in a Company. Therefore, the responsibilities of the Board of a CSR-eligible Company, include the following actions -

(i) Approve the CSR Policy of the Company;

(ii) Disclose the contents of such Policy in Board;

(iii) Place the content of CSR Policy on the Company's website;

(iv) Ensure that the CSR activities have been done as per the CSR Policy;

(v) Ensure that the Company spends CSR funds in accordance with the section 135(5) of the Companies Act, 2013;

(vi) Satisfy itself regarding the utilisation of the disbursed CSR funds of the Company; and

(vii) If the Company fails to spend at least two per cent of the average net profits of the Company, the Board shall, in its report specify the reasons for not spending the amount and transfer the unspent CSR amount as per provisions of sections 135(5) and 135(6) of the Act.

8) Calculation of CSR Expenditure

Companies which satisfies any of the criteria mentioned under section 135(1), needs to expend at least 2% of the average Net Profit earned during the preceding 3 financial years. The calculation of the average Net Profit is presented in the below table:

Particulars		CSR Expenditure Calculations
Case 1:		
Incorporated in FY	:	2018-19
Fulfils any criteria of section 135(1) in FY	:	2018-19
CSR Expenditure requires in the Year	:	2019-20
Net Profit in FY 2018-19	:	Rs.5 Cr.
Amount of CSR in 2019-20	:	2% of Net Profit for the year 2018-19 **= Rs.5 Cr. X 2/100** **= Rs.10 Lakhs**

Particulars		CSR Expenditure Calculations
Case 2:		
Incorporated in FY	:	2018-19
Fulfils any criteria of section 135(1) in FY	:	2019-20
CSR Expenditure requires in the Year	:	2020-21
Net Profit in FY 2018-19	:	Rs.5 Cr.
Net Profit in FY 2019-20	:	Rs.4 Cr.
Amount of CSR in 2020-21	:	2% of Average Net Profit for the year 2018-19 and 2019-20 **= (Rs.5 Cr. + Rs.4 Cr.) / 2 X 2/100** **= Rs.9 Lakhs**
Case 3:		
Incorporated in FY	:	2018-19
Fulfils any criteria of section 135(1) in FY	:	2020-21
CSR Expenditure requires in the Year	:	2021-22
Net Profit in FY 2018-19	:	Rs.5 Cr.
Net Profit in FY 2019-20	:	Rs.4 Cr.
Net Profit in FY 2020-21	:	Rs.3 Cr.
Amount of CSR in 2021-22	:	2% of Average Net Profit for the year 2018-19, 2019-20, and 2020-21 **= (Rs.5 Cr. + Rs.4 Cr. + Rs.3 Cr.) / 3 X 2/100** **= Rs.8 Lakhs**
Case 4:		
Incorporated in FY	:	2018-19
Fulfils any criteria of section 135(1) in FY	:	2021-22
CSR Expenditure requires in the Year	:	2022-23
Net Profit in FY 2018-19	:	Rs.5 Cr.
Net Profit in FY 2019-20	:	Rs.4 Cr.
Net Profit in FY 2020-21	:	Rs.3 Cr.
Net Profit in FY 2021-22	:	Rs.8 Cr.
Amount of CSR in 2022-23	:	2% of Average Net Profit for the year 2019-20, 2020-21, and 2021-22 **= (Rs.4 Cr. + Rs. 3 Cr. + Rs.8 Cr.) / 3 X 2/100** **= Rs.10 Lakhs**

Conclusion

The CSR expenditure has to be made in the succeeding financial year or years, as decided by the Board, of the previous year in which the CSR provisions are applicable

as per the criteria mentioned in section 135(1) of the Companies Act, 2013.

Further, if the Company has been established for less than 3 financialyears, then the average net profit would be calculated during the period of its establishment.

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