

TAXATION OF NPOs

U/S 13(10)

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NOT FULFILLING THE CONDITIONS OF REGISTRATION



Standards & Norms

Resource support on NGO Governance, Accounting and Regulations



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INTRODUCTION AND OVERVIEW

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

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

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of non-compliance, such incomes shall not be subject to application and/or the benefit of sections 11 and 12 will be withdrawn or the registration status will be lost for that particular year of non-compliance.

In this issue we shall discuss the provisions of section 13(10) which become applicable when an organisation fails to comply with the conditions under section 11 with regard to application of income.

VARIOUS TYPES OF PENAL TAXATION OF NPOs

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

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- (ii) When benefits of Sections 11 and 12 are withdrawn for a specified reason, the income will be subject to tax as per section 13(10), read with section 164(2).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

NON-COMPLIANCES SUBJECT TO SECTION 13(10) AND 13(11)

3.01 The Finance Act 2022 inserted Section 13(10) with effect from the assessment year 2023-24 to provide that in the specified situations, the income chargeable to tax shall be computed after allowing a deduction for expenditure incurred for the objects of the institution. Further, the newly inserted Section 13(11) provides that no deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any other provision of the Act.

3.02 It is to be noted that up to the assessment year 2022-23, these violations resulted in the withdrawal of benefits under sections 11 and 12 and the entire income of the organisation was subject to tax under section 164(2) of the Income-tax Act

without any benefit of the application of income. However, after the insertion of Sections 13(10) and 13(11), such income will be subject to the provisions of Sections 13(10) & (11).

3.03 Text of Section 13(10) and 13(11)

(10) Where the provisions of sub-section (8) are applicable to any trust or institution or it violates the conditions specified under clause (b) or clause (ba) of sub-section (1) of section 12A, its income chargeable to tax shall be computed after allowing 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 the trust or institution as on the end of the financial year immediately preceding the previous year relevant to the assessment year for which 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 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.*

Explanation.—For the purposes of determining the amount of expenditure under this sub-section, the provisions of sub-clause (ia) of clause (a) of section 40 and sub-sections (3) and (3A) of section 40A, shall, mutatis mutandis, apply as they apply in computing the income chargeable under the head “Profits and gains of business or profession”.

(11) For the purposes of computing income chargeable to tax under sub-section (10), no deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed to the assessee under any other provision of this Act.

SITUATIONS ATTRACTING SECTION 13(10)

4.01 In the following situations, the income chargeable to tax shall be computed after allowing a deduction for expenditure incurred for the objects of the institution:

(a) Commercial receipts in excess of 20%: The seventh category NGOs under section 2(15) i.e., for advancement of any other object of general public utility, can have specified business activity upto 20% of gross receipt as amended by Finance Act, 2015. If the seventh category NGOs have incidental business activity in excess of 20% of gross receipt, then their charitable status will not be lost, but their income shall be computed as per newly inserted section 13(10) & 13(11).

(b) Non-Obtaining and/or Non-furnishing of Audit Report: Section 12A prescribes the conditions that a charitable institution must fulfil in order to be eligible for exemption under Sections 11 and 12. Among these essential conditions are, registration under Section 12AB, re-registration on modification of objects, maintenance of books of account, audit of accounts, and filing of the income tax return.

Thus, to avail the exemption under Section 11 and Section 12, it is mandatory for a trust to get its books of accounts audited. The books of account are required to be audited where the total income of the trust before exemption under section 11 and 12 exceeds the maximum amount not chargeable to tax.

After the Finance Act, 2020, it has become mandatory that the Audit Report should be obtained and also furnished one month prior to due date of filing the return under section 139(1). Hence, if the trust fails to obtain the audit report or fails to upload the Audit report one month prior to due date of filling the

Return, the income shall be subject to tax on the income computed in the manner specified under sections 13(10) and 13(11).

(c) Non-filing of Income-Tax Return: The entities registered under section 12AB are required to file a return of income under section 139(4A) by virtue of section 12A(1) if the total income without giving effect to the provisions of sections 11 and 12 exceeds the maximum amount which is not chargeable to income-tax. The condition for filing of return of income has to be examined every year. In case a charitable institution does not file its return of income within the required time, it shall be subject to tax on the income computed as per newly inserted sections 13(10) and 13(11).

(d) Non-maintenance of Books of Accounts: Trust or institutions, having income exceeding the maximum amount not chargeable to tax, shall also be required to keep and maintain books of account and other documents in such form and manner and at such place, as may be provided by rules. (Requirement inserted by the Finance Act, 2022 w.e.f. A.Y. 2023-24).

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 maintain books of accounts as prescribed, then also the income shall be subject to tax under sections 13(10) and 13(11).

HOW SHALL INCOME BE COMPUTED?

5.01 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.

5.02 **Applicability of disallowance provisions:** 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.

EXEMPTION/BENEFITS WHICH SHALL NOT BE AVAILABLE WHILE COMPUTING INCOME

- 6.01** It is to be noted that the following exemption/benefit shall not be available when income is computed under section 13(10) & 13(11):
- (a) Capital expenses shall not be considered as the application of income
 - (b) Inter-charity donation shall not be considered as application

- (c) No benefit of statutory accumulation of 15%
- (d) No provision for applying for accumulation as available as per normal computation provision.

6.02 Surplus Income and Tax Rate: The income computed under sections 13(10) and 13(11) shall be subject to tax under section 164(2).

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