

UNREGISTERED NPOs ARE ELIGIBLE FOR TAX BENEFIT AVAILABLE TO AN INDIVIDUAL



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INTRODUCTION

1.1.1 The charitable organisations which do not have 12AA registration are subjected to tax on their income. It has been noticed small NPOs are being issued large tax demand notices against their income which is below taxable limit. For instance if any NPO has a taxable income of Rs. 2 lakh its tax liability should be nil, however, it has been noticed that the entire income is taxed at maximum marginal rate without providing the benefit of slab rates applicable to individuals for AOP (Association of Persons). In this issue we shall discuss the Income Tax provisions which provide that unregistered NPOs are eligible for tax benefits available to individuals or AOP. To further clarify, if an NPO's taxable is Rs. 5 lakh then its tax liability will be NIL if it is taxed at the rates applicable to individual, on the contrary if it is taxed at maximum marginal rate then the tax liability will be more than Rs. 1.5 lakh.

UNDERSTANDING THE PROVISIONS

- 1.2.1** When the income of a charitable organisation becomes taxable it is taxed at the rate applicable to an Association of Persons. The taxes are determined on the basis of the provisions of section 164(2) and (3).
- 1.2.2** The charitable organisations which do not have 12AA registration are subjected to tax as individuals or AOP.
- 1.2.3** It may also be noted that expenditure towards charitable activity are also not allowed to be deducted. In other words, the donations and other income will be taxed like any other assessee, any charitable activity conducted out of the donation will not be allowed as an admissible expense.
- 1.2.4** An admissible expenditure should be in a nature of charge against the income, in other words under law only those expenditures are permissible which are spent to earn the corresponding income. For example if a charitable organisation has received Rs. 5 lakh as donation (voluntary contribution) and

has spent the entire amount towards charitable activities, still its taxable income will be Rs. 5 lakh.

- 1.2.5** It has been noted in the past that the Assessing Officers have been issuing tax demand notices by computing the Income Tax at maximum marginal rate. When income is taxed at maximum marginal rate then the tax is levied on the entire income, on the contrary for individuals Income Tax is exempted upto Rs. 5 lakh of income.
- 1.2.6** However, a careful reading of the Income Tax Act suggest that charitable NPOs cannot be taxed at maximum marginal rate. Further, there are CBDT Circulars and judicial precedence in support of allowing the tax benefits available to individuals or AOP.

THE APPLICABLE PROVISIONS OF THE INCOME TAX ACT

- 1.3.1** Provisions of section 164(2) & (3) of Income Tax Act, 1961, provide that the following nonexempt portion of income under section 11 or 12 shall be charged to tax at the rate of tax applicable to the income of an Association of Persons :
- (i) The portion of income derived from property held under trust either wholly or partly for charitable or religious purposes.
 - (ii) Voluntary contributions as defined under section 2(24)(iia).
 - (iii) Business income as derived under section 11(4A).
- 1.3.2** In other words the above provisions make it clear that only the above type of income shall be subjected to tax at maximum marginal rate. All other income of a trust shall be taxed at the rate applicable to a individual.
- 1.3.3** In addition to the above provisions, there is a proviso to section 164(2), which provides that, where the income becomes taxable by virtue of section 13(1)(c) or 13(1)(d), the tax shall be charged on the relevant income at maximum marginal rate. The text of section 164 is provided in **Annexure 1**.

1.3.4 To sum up, from the above provisions, it can be said that the non-exempt income of a charitable or religious organisation will be taxed at the rates applicable to an AOP and they will be entitled to the basic exemption limit. But, when the income becomes taxable due to the contravention mentioned under section 13(1)(c) & (d), then that particular portion of income will be taxed at the maximum marginal rate and the remaining income will be taxed at normal rates.

CBDT CIRCULAR NO. 387, DATED 6-7-1984

1.4.1 The CBDT has clarified this vide Circular No. 387, dated 6-7-1984. The CBDT interpreted the proviso to section 164(2) and 164(3) to imply that in case of organizations contravening the provisions of section 13(1)(c) & (d), they will be taxed at the maximum marginal rate only on that part of income which has forfeited the exemption under the said provisions.

1.4.2 *It may be noted that section 164(2) and 164(3) do not put any condition regarding 12AA registration, it is a section independent of the provision pertaining to exemptions. In case of for Public Charitable Trust the issue of determinate or indeterminate beneficiaries is irrelevant as the beneficiaries are public at large, therefore section 164(2) does not provide for any such condition. In case of trust with private beneficiaries the issue of determinate or indeterminate beneficiaries is relevant. It is a settled law that charitable or religious trust shall eligible for the basic exemption limit and shall be taxed under normal rate of taxes.*

CBDT CIRCULAR NO. 320 DATED 11-1-1982

1.5.1 CBDT has also issued a circular No. 320 [F. No. 131(31)/81-TP(Pt.)], dated 11-1-1982 regarding applicability of tax rates as individual for charitable and religious trust. The text of the circular is as under:

“Whether the section is applicable to income received by trustees

on behalf of provident funds created exclusively for the benefit of employees

1. A reference is invited to paragraph 15.1 to 15.7 of the Explanatory Notes on the provisions relating to direct taxes in the Finance Act, 1981 [Circular No. 308, dated 29-6-1981] which explain the scope and ambit of section 167A, as inserted by the Finance Act, 1981.
2. A question has been raised whether the provisions of section 167A of the Income-tax Act which provide for charging of tax at the maximum marginal rate on the total income of an association of persons where the individual shares of members in the income of such association are indeterminate or unknown would also apply to income receivable by trustees on behalf of provident funds, superannuation funds, gratuity funds, pension funds, etc., created bona fide by persons carrying on business or profession exclusively for the benefit of the persons employed in such business. The Board have been advised that cases where income received by the trustees on behalf of a recognised provident fund, approved superannuation fund and approved gratuity fund is governed by section 10(25) of the Income-tax Act, the question of their being charged to tax does not arise. So far as cases where income is receivable by the trustees, on behalf of an unrecognized provident fund or an unapproved superannuation fund, gratuity fund, pension fund or any other fund created bona fide by a person carrying on a business or profession exclusively for the benefit of persons employed in such business or profession are concerned, they will continue to be charged to tax in the manner prescribed by section 164(1)(iv) of the Income-tax Act, as hitherto. **Similarly, in the cases of registered societies, trade and professional associations, social and sports clubs, charitable or religious trusts, etc., where the members or trustees are not entitled to any share in the income of the association of persons, the provisions of new section 167A will not be attracted and,**

accordingly, tax will be payable in such cases at the rate ordinarily applicable to the total income of an association of persons and not at the maximum marginal rate.”

- 1.5.2** In the light of the above circular it is clear that charitable and religious organisations registered as societies or trust shall not be taxed at Maximum Marginal Rate.

CASE LAWS IN THIS REGARD

- 1.6.1** It has been held that, though the rate applicable to public charitable or religious organisations is that of an Association of Persons, the status of the organisation for the purposes of taxation would be that of an individual. In *DIT (Exemption) v. Shardaben Bhagubhai Mafatlal Public Charitable Trust* [2001] 247 ITR 1 (Bom.), the issue was whether the assessee-trust was assessable as an individual and, consequently, entitled to deduction under section 80L of the Act? The Bombay High Court held that, the term “individual” does not mean a single living human being. It can include a body of individuals constituting a unit for the purposes of the Act. Even though the assessment of income was in the hands of the trust, it had to be made in the same manner and to the same extent as it would have been made in the hands of the beneficiaries. Therefore, it was held that the representative assessee in the case of a discretionary trust must be regarded as an individual and it would be entitled to the benefit of deduction under section 80L of the Act.
- 1.6.2** In the case of *DIT v. Agrim Charan Foundation* [2001] 119 Taxman 569 (Delhi) it was held that innocent violation of section 11(5) would not attract forfeiture of exemption. In this case, the assessee had invested in the fixed deposits of two companies which were not covered under section 11(5). The investment was withdrawn when the assessee became aware of such violation. The Court held that violation without any mala fide intention will not result in the forfeiture of exemption. Therefore, under the prevailing law barring exceptions

and innocent violations, it seems that wilful violation of section 11(5) in prohibited investments will result in forfeiture of entire income and the investment amount shall be taxed at maximum marginal rate. In *Gurdayal Berlia Charitable Trust v. Fifth ITO* [1990] 34 ITD 489 (Bom.), the Tribunal observed that only the income from unapproved investment would be taxable at the maximum marginal rate while the rest of the income would be exempt.

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SECTION 164 OF INCOME-TAX ACT, 1961

Charge of tax where share of beneficiaries unknown

164. (1) Subject to the provisions of sub-sections (2) and (3), where any income in respect of which the persons mentioned in clauses (iii) and (iv) of sub-section (1) of section 160 are liable as representative assessee or any part thereof is not specifically receivable on behalf or for the benefit of any one person or where the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable are indeterminate or unknown (such income, such part of the income and such persons being hereafter in this section referred to as “relevant income”, “part of relevant income” and “beneficiaries”, respectively), tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate :

Provided that in a case where—

- (i) none of the beneficiaries has any other income chargeable under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust; or
- (ii) the relevant income or part of relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him; or
- (iii) the relevant income or part of relevant income is receivable under a trust created before the 1st day of March, 1970, by a non-testamentary instrument and the Assessing Officer is satisfied, having regard to all the circumstances existing at the relevant time, that the trust was created *bona fide* exclusively for the benefit of the relatives of the settler, or where the settler is a Hindu undivided family, exclusively for the benefit of the members of such family, in circumstances where such relatives or members were mainly dependent on the settler for their support and maintenance; or
- (iv) the relevant income is receivable by the trustees on behalf of a provident fund, superannuation fund, gratuity fund, pension fund or any other fund created *bona fide* by a person carrying on a business or profession

exclusively for the benefit of persons employed in such business or profession, tax shall be charged on the relevant income or part of relevant income as if it were the total income of an association of persons :

Provided further that where any income in respect of which the person mentioned in clause (iv) of sub-section (1) of section 160 is liable as representative assessee consists of, or includes, profits and gains of business, the preceding proviso shall apply only if such profits and gains are receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him.

(2) In the case of relevant income which is derived from property held under trust wholly for charitable or religious purposes, or which is of the nature referred to in sub-clause (iia) of clause (24) of section 2, or which is of the nature referred to in sub-section (4A) of section 11, tax shall be charged on so much of the relevant income as is not exempt under section 11 or section 12, as if the relevant income not so exempt were the income of an association of persons :

Provided that in a case where the whole or any part of the relevant income is not exempt under section 11 or section 12 by virtue of the provisions contained in clause (c) or clause (d) of sub-section (1) of section 13, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

(3) In a case where the relevant income is derived from property held under trust in part only for charitable or religious purposes or is of the nature referred to in sub-clause (iia) of clause (24) of section 2 or is of the nature referred to in sub-section (4A) of section 11, and either the relevant income applicable to purposes other than charitable or religious purposes (or any part thereof) is not specifically receivable on behalf or for the benefit of any one person or the individual shares of the beneficiaries in the income so applicable are indeterminate or unknown, the tax chargeable on the relevant income shall be the aggregate of—

- (a) the tax which would be chargeable on that part of the relevant income which is applicable to charitable or religious purposes (as reduced by the income, if any, which is exempt under section 11) as if such part (or such part as so reduced) were the total income of an association of persons; and
- (b) the tax on that part of the relevant income which is applicable to purposes other than charitable or religious purposes, and which is either not specifically

receivable on behalf or for the benefit of any one person or in respect of which the shares of the beneficiaries are indeterminate or unknown, at the maximum marginal rate :

Provided that in a case where—

- (i) none of the beneficiaries in respect of the part of the relevant income which is not applicable to charitable or religious purposes has any other income chargeable under this Act exceeding the maximum amount not chargeable to tax in the case of an association of persons or is a beneficiary under any other trust; or
- (ii) the relevant income is receivable under a trust declared by any person by will and such trust is the only trust so declared by him; or
- (iii) the relevant income is receivable under a trust created before the 1st day of March, 1970, by a non-testamentary instrument and the Assessing Officer is satisfied, having regard to all the circumstances existing at the relevant time, that the trust, to the extent it is not for charitable or religious purposes, was created *bona fide* exclusively for the benefit of the relatives of the settler, or where the settler is a Hindu undivided family, exclusively for the benefit of the members of such family, in circumstances where such relatives or members were mainly dependent on the settler for their support and maintenance, tax shall be charged on the relevant income as if the relevant income (as reduced by the income, if any, which is exempt under section 11) were the total income of an association of persons :

Provided further that where the relevant income consists of, or includes, profits and gains of business, the preceding proviso shall apply only if the income is receivable under a trust declared by any person by will exclusively for the benefit of any relative dependent on him for support and maintenance, and such trust is the only trust so declared by him :

Provided also that in a case where the whole or any part of the relevant income is not exempt under section 11 or section 12 by virtue of the provisions contained in clause (c) or clause (d) of sub-section (1) of section 13, tax shall be charged on the relevant income or part of relevant income at the maximum marginal rate.

Explanation 1.—For the purposes of this section,—

- (i) any income in respect of which the persons mentioned in clause (iii) and clause (iv) of sub-section (1) of section 160 are liable as representative assessee

or any part thereof shall be deemed as being not specifically receivable on behalf or for the benefit of any one person unless the person on whose behalf or for whose benefit such income or such part thereof is receivable during the previous year is expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and is identifiable as such on the date of such order, instrument or deed ;

- (ii) the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is received shall be deemed to be indeterminate or unknown unless the individual shares of the persons on whose behalf or for whose benefit such income or such part thereof is receivable, are expressly stated in the order of the court or the instrument of trust or wakf deed, as the case may be, and are ascertainable as such on the date of such order, instrument or deed.

Explanation 2.—[Omitted by the Direct Tax Laws (Amendment) Act, 1987, w.e.f. 1-4-1989]

