



## This document has been provided by the International Center for Not-for-Profit Law (ICNL).

ICNL is the leading source for information on the legal environment for civil society and public participation. Since 1992, ICNL has served as a resource to civil society leaders, government officials, and the donor community in over 90 countries.

Visit ICNL's **Online Library** at  
<http://www.icnl.org/knowledge/library/index.php>  
for further resources and research from countries all over the world.

### Disclaimers

**Content.** The information provided herein is for general informational and educational purposes only. It is not intended and should not be construed to constitute legal advice. The information contained herein may not be applicable in all situations and may not, after the date of its presentation, even reflect the most current authority. Nothing contained herein should be relied or acted upon without the benefit of legal advice based upon the particular facts and circumstances presented, and nothing herein should be construed otherwise.

**Translations.** Translations by ICNL of any materials into other languages are intended solely as a convenience. Translation accuracy is not guaranteed nor implied. If any questions arise related to the accuracy of a translation, please refer to the original language official version of the document. Any discrepancies or differences created in the translation are not binding and have no legal effect for compliance or enforcement purposes.

**Warranty and Limitation of Liability.** Although ICNL uses reasonable efforts to include accurate and up-to-date information herein, ICNL makes no warranties or representations of any kind as to its accuracy, currency or completeness. You agree that access to and use of this document and the content thereof is at your own risk. ICNL disclaims all warranties of any kind, express or implied. Neither ICNL nor any party involved in creating, producing or delivering this document shall be liable for any damages whatsoever arising out of access to, use of or inability to use this document, or any errors or omissions in the content thereof.

**M. KANDASAMI**

**MANAGEMENT  
OF  
FINANCES  
IN  
NON-PROFIT  
ORGANISATIONS**

**CARITAS INDIA  
NEW DELHI**

## **FORMATION OF A NON-PROFIT ORGANISATION**

### **2.1. Introduction**

It is advisable for any group wanting to commence a non-profit, voluntary or charitable work to organise themselves into a legal body. In fact, there are mandatory provisions which require such groups to be incorporated as legal bodies.

The body that is incorporated becomes a legal person just like an individual, but with no physical existence. As such, it can acquire and hold property and can sue and be sued. Thus, an incorporated body has a separate existence, distinct from that of its members. An unincorporated body may exist in fact, but is not considered to exist in law.

Although the law might not require incorporation in certain cases, there is a practical necessity for it, since many benefits are available only for legally incorporated bodies.

### **2.2. Advantages of Incorporation:**

- a. It gives a legal right to the members to hold property in a common name.
- b. It means the legal body can sue and be sued in its own name.
- c. Any property held can pass from one generation to another without having to pay any transfer fees or taxes and without any cumbersome documentation.
- d. The properties of an incorporated body can be more easily protected from rival claimants.
- e. Numerous benefits are available to an incorporated body e.g. exemption from various Tax Laws, land ceiling regulations etc.
- f. Registration under the Foreign Contribution (Regulation) Act, 1976 and the Income Tax Act, 1961 is more easily granted if the non-profit organisation is incorporated.

### **2.3. Forms of Incorporation (Registration)**

There are generally three forms of registration available in India for incorporating a non-profit organisation, as follows:

- a) Societies
- b) Public Trusts
- c) Non-profit Companies

#### **a) Registration Under the Societies Registration Act, 1860:**

The Societies Registration Act of 1860 is an All India Act but many states have, while applying the act to themselves, modified some of its clauses with occasional additions. A few States have enacted their own Societies Registration Act. Hence a Society can be registered either under the Central Act or the respective State Act.

#### **b) Registration as a Public Charitable Trust:**

For this, a Deed of Trust has to be framed incorporating the necessary provisions for management of the affairs and objects of the organisation. This Deed has to be registered with the Sub-Registrar of the Registration Department of the respective State Government.

#### **c) Registration Under the Companies Act, 1956:**

The Companies Act, 1956 is an All-India Act, and the states have no authority to change or modify it.

A Company is generally meant for the corporate sector, nevertheless there is a provision in the Companies Act for institutions that have no business character and no profit motivation to be registered under it. This is provided in section 25 of the Companies Act, 1956.

### **2.4. Additional Registration:**

#### **a) Registration Under Public Trust Act:**

In certain states like Maharashtra and Gujarat, there is a Public Trusts Act, which obliges institutions that have the nature of Public Trusts to get registered as such under the State's Public Trusts Act.

According to the Bombay Public Trusts Act, 1950, all charitable and religious institutions are to be registered as Public Trusts and will come under the supervision of the Charity Commissioner.

**b) Registration Under the Societies Act and then under The Public Trust Act:**

Many of the institutions in Bombay are first registered freely as societies under the Societies Registration Act of 1860 and then they are registered under the Public Trusts Act which is obligatory.

This double registration under the Societies Act and the Public Trusts Act is required only in places where the Public Trusts Act is in vogue.

**c) Linkage of Small Organisations to a Central Organisation:**

In some cases, individual institutions which form part of a larger organisation are registered under the Societies Act and then the Central Organisation is registered as a company in the form of a holding company.

**d) Registration under the Income Tax Act 1961**

In order to be entitled for exemption under section 11 of the Income Tax Act 1961, an organisation should obtain registration under section 12A of the Act. Please refer to Chapter 9 for more details.

**e) Registration under Foreign Contribution Regulation Act, 1976**

In order to be eligible to accept foreign contribution from foreign funding organisations or other foreign sources or any other foreign contribution as defined in the FCRA an organisation should get registration under FCRA. Please refer to Chapter 9 for more details.

**2.5. Obligations of Incorporation:**

- a. The organisation must work within its objects and according to the by-laws framed.
- b. At regular intervals the authorities are to be kept informed as to who are the members of the Governing Body.
- c. Separate Minutes Books must be kept to record the main decisions and policies made by the Governing Body or the General Body of the members of the Society.
- d. A regular account must be kept of the financial affairs of the organisation and they must be duly audited by a Chartered Accountant as stipulated by law.
- e. In the case of Societies the audited accounts must be adopted by the General Body at an Annual General Meeting and be filed along

with the relevant required documents with the Registrar of Societies within the prescribed time limit according to the respective State Acts.

In short there is a certain amount of supervision of the affairs of an organisation by Government authorities in the general interest of the public.

## **2.6. Advantages and Disadvantages of different types of Incorporation**

### **a) Registration as a Society**

#### **1. Advantages:**

- It is a corporate body.
- It is easy to make amendments to the Memorandum and bye-laws.

#### **2. Disadvantages:**

- It is less flexible.
- Many procedural formalities have to be followed.

### **b) Charitable Trust**

#### **1. Advantages:**

- This method gives flexibility in terms of provisions for management of the affairs of the organisation. Any type of structure of management can be provided in the Deed of Trust.
- Reporting and procedural formalities are relatively less in this method.

#### **2. Disadvantages:**

There are no specific disadvantages in this method in comparison with other methods.

### **c) Registration as a Charitable Company under the Companies Act:**

#### **1. Advantages:**

- It is a corporate body.
- The organisation can be broad based by taking many members.

#### **2. Disadvantages:**

- It is the most procedural of all the methods.
- There is more reporting to and control by the Government.

## 2.7 Conclusion

While it is undoubtedly advantageous to register a non-profit organisation as a legal entity, there is no consensus as to the best form of incorporation. This decision depends on various factors e.g. the nature of activity, the management structure, the intention of the founders etc.

It is always advisable to consult a legal expert who is familiar in the area of non-profit organisations.

## 2.8. Check - list

1. Prepare a vision document articulating with clear objectives and goals the long term perspectives and plans and short term activities.
2. Reflect on the management structure and the administrative aspect of the organisation.
3. Consult a legal expert and decide the form of incorporation.
4. Prepare a documentation e.g. Memorandum of Association or Trust Deed incorporating the unique vision of the organisation.
5. Complete the legal formalities regarding incorporation/registration of the legal body.
6. Immediately carry out the registrations (Income Tax, FCRA, Public Trust Act, etc.) as may be required.

## COMPLIANCE OF LAWS, RULES AND REGULATIONS

### 9.1. Foreign Contribution (Regulation) Act 1976

#### 9.1.1. Introduction

This Act was passed to regulate the flow of foreign contribution i.e. funds, into the country through certain persons and associations with a view to ensuring that parliamentary institutions, political associations, academic and other voluntary associations as well as individuals working in important walks of life, may function in accordance with the values of a Sovereign Democratic Republic.

The Act is meant to regulate the receipt and utilisation of foreign contribution. Unlike Direct and Indirect Taxes which levy tax or duty, the Foreign Contribution (Regulation) Act does not levy any tax or duty but is regulatory in nature.

Throughout this chapter the Foreign Contribution (Regulation) Act shall be referred to as FCRA for easy reference.

#### 9.1.2. Applicability

This Act applies to :

- i. any association whether registered as a legal entity, (Society, Trust or Charitable Company) or not, having an office in India with the objective of carrying out cultural, economic, educational, religious or social programmes.
- ii. any citizen of India whether residing in India or outside India.
- iii. any foreign branch or subsidiary or associate of any Indian organisation.

#### 9.1.3. What is Foreign Contribution?

The receipt of any currency, (whether Indian or foreign), articles or a security from a foreign source is defined as foreign contribution and it includes any donation, delivery or transfer made by the foreign source.

Foreign contribution also includes contributions received from one or more organisations within India whose original source is foreign e.g. Organisation 'A' receives funds from foreign source 'B'. 'A' further transfers some of these funds to another organisation, 'C', which further transfers some of these funds to another organisation, 'D'. All these transactions are of foreign contributions and



thus organisations 'C' and 'D' are also in receipt of foreign contribution in addition to organisation 'A'. It is the duty of the organisation which transfers the funds to ensure that no foreign contribution is transferred to any organisation which is not registered under the FCRA or which has not obtained Prior Permission.

#### **9.1.4. Who can Receive Foreign Contribution?**

- i) Certain organisations can receive foreign contribution after obtaining registration as required under section 6(1) of the Act. These are :  
any Society, Trust or Charitable Company carrying on educational, charitable, religious, economic, cultural or social welfare activities.
- ii) Certain other organisations, which are not registered under section 6(1) of the Act or are denied registration by the Central Government, can receive foreign contribution only after obtaining Prior Permission under section 6(1A) of the Act.
- iii) Certain other organisations, which are not eligible for registration under the Act, can receive foreign contribution only after obtaining Prior Permission every time before accepting the contributions. They are organisations which are notified by the Central Government as being of political nature although they are not political parties as defined under section 5(1) of the Act.

#### **9.1.5. Who cannot Receive Foreign Contribution?**

Certain persons are totally prohibited from receiving any foreign contributions. They are as follows:

- i. Candidates for political elections
- ii. Correspondents, columnists, cartoonists, editors, owners, printers or publishers of a newspaper registered under the Press and Registration of Books Act, 1867.

Note: In the case of publications which are categorised by the Registrar of Newspapers India to be of category B, the Central Government can grant exemption from the provisions of this clause. Please refer to order no. II/21022/14(5)/87-FCRA-I dated 4-8-1987 issued by the Government of India, Ministry of Home Affairs (see Appendix 2).

For seeking exemption, the owner/printer/publisher has to apply to the Registrar of Newspapers of India enclosing a few copies of their publications with a request to grant a category B certificate. This certificate is usually granted only to those publications which do not carry any political news and views. Once a category B certificate has been obtained the applicant has to furnish a declaration (see Appendix 2) enclosing this and send it to the FCRA Division of the

Ministry of Home Affairs (MHA). The necessary exemption order may then be granted.

It will be valid for one year and is required to be renewed annually.

- iii. Judges
- iv. Government servants or employees of a Government Company or Corporation owned or controlled by the Government
- v. Members of State Legislatures
- vi. Political parties or their office bearers

#### 9.1.6. What is Foreign Source?

Foreign source as defined under the FCRA includes the following :

- i. the Government of any foreign country or territory and any agency of such Government,
- ii. any international agency, not being the United Nations or any of its specialised agencies, the World Bank, the International Monetary Fund or such other agency as the Central Government may, by notification in the Official Gazette, specify in this behalf,
- iii. a foreign company within the meaning of Section 591 of the Companies Act, 1956 (1 of 1956); this includes:
  - a. a company which is a subsidiary of a foreign company and
  - b. a multi-national corporation within the meaning of this Act,
- iv. a corporation, not being a foreign company, incorporated in a foreign country or territory,
- v. a multi-national corporation within the meaning of this Act,
- vi. a company within the meaning of the Companies Act, 1956 (1 of 1956), if more than one half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following, namely:
  - a. the Government of a foreign country or territory,
  - b. the citizens of a foreign country or territory,
  - c. corporations incorporated in a foreign country or territory,
  - d. trusts, societies or other associations of individuals, (whether incorporated or not), formed or registered in a foreign country or territory,
- vii. a trade union in any foreign country or territory, whether or not registered in such foreign country or territory,
- viii. a foreign trust by whatever name called, or a foreign foundation which is either in the nature of a trust or is mainly financed by a foreign country or territory,

- ix. a society, club or other association of individuals formed or registered outside India,
- x. a citizen of a foreign country.

#### **9.1.7. What is Not Foreign Source?**

The following are not considered as foreign source:

- i. any foreign institution permitted by the Central Government through a Gazette notification to carry on its activities in India
- ii. the United Nations
- iii. any of the specialised agencies of the United Nations
- iv. the World Bank
- v. the International Monetary Fund
- vi. any other agency which may be notified in the Official Gazette by the Central Government. The following are some of the Agencies notified in the Official Gazette by the Central Government:
  - 1. United Nations Outer Space Committee
  - 2. International Rice Research Institute, Philippines
  - 3. International Potato Centre, Peru
  - 4. International Crops Research Institutes of Semi-Arid Tropics, Hyderabad
  - 5. International Sugar Organisation, London
  - 6. Asian Productivity Organisation, Tokyo
  - 7. Asian and Pacific Development Administration, Kuala Lumpur
  - 8. Asian African Legal Consultative Committee, New Delhi

#### **9.1.8. How to Obtain Registration?**

It is preferable to fulfill the following requirements in order to obtain registration:

- i. The applicant organisation should preferably be incorporated as a legal entity, namely as a society, trust or a charitable company.
- ii. Such an organisation should have been working for a period of at least three years.
- iii. There should have been no pre-existing violation e.g. receipt of foreign contribution without Prior Permission.
- iv. The activities carried on for the last three years should be proved by supplying the relevant activity reports and audited statements.

The application has to be made in Form FC-8, (see Appendix 2), along with the following enclosures:

- i. The Memorandum of Association
- ii. A list of the office bearers of the organisation
- iii. A report on the activities of the organisation
- iv. A copy of the audited accounts for the last three years

The application should be duly filled in including the following information:

- i. The nature of the association/organisation
- ii. The name of the religion in the case of a religious organisation e.g. Hindu, Muslim, Christian etc.
- iii. The main objects
- iv. The names and addresses of the important office bearers
- v. The name and address of the chief functionary
- vi. The name of the bank, branch, address and account number designated by the applicant organisation to receive foreign contribution.

After receipt of the application, the FCRA division normally sends a questionnaire asking for a few clarifications and the applicant organisation should submit the necessary answers immediately.

The MHA requires the following supplementary information for processing the registration application:

1. Whether the association is functioning as editor, owner, printer or publisher of a registered newspaper or magazine registered under the Press Book Registration Act, 1867. If so, details should be provided.
2. Whether the association has any parent and/or sister concerns. If so please mention:
  - i. their FCRA Registration number, and/or
  - ii. the reference number and date.
3. Whether any other application was filed earlier. If so, mention its date and reference number and the date of any communication received from the Ministry.
4. Whether the association is in receipt of foreign contribution and whether Prior Permission was obtained or not.
5. Details of activities during the past three years.
6. Details of its area of operation.
7. Details of the paid staff employed both full time and part time.

8. Details of movable/immovable assets owned by the association.
9. The audited statements of accounts for the previous three years.

If the above details are provided in advance, it will save time in terms of answering the questionnaire from the MHA.

Normally the MHA verifies the claims of the applicant organisation about its activities through its sources before taking a decision as to whether or not to grant registration under the FCRA.

After the above process the FCRA division either grants registration or rejects the application. The organisations who are denied registration can then only accept foreign contribution by obtaining Prior Permission under section 6(1A) of the Act.

#### **9.1.9. How to obtain Prior Permission?**

Prior Permission is required only if the organisation is either not already registered or has been refused registration under the Act.

Prior Permission can be obtained only for a specific amount from one or more specific agencies and is not a blanket permission to receive any amount from any agency for any project.

The application has to be made in Form FC-1A (see Appendix 2). In the case of organisations notified under section 5(1) of the Act, Form FC-1 is applicable, (see Appendix 2). The application should be forwarded with the following enclosures:

- i. a commitment letter from the Donor Agency,
- ii. a project report of the activity to be carried out including the amount required and the time plan to carry out the activity along with a copy of the estimated budget,
- iii. a copy of the Gazette notification of the Central Government directing the organisation to such acceptance of Prior Permission, if any.

The application should be duly filled in including the following information:

- i. the nature of the contribution whether cash or kind,
- ii. value of the amount to be received,
- iii. the mode and the channel of receipt,
- iv. particulars of the foreign source,
- v. the nature of relationship with the foreign source,
- vi. the name of the bank and address of the branch along with the bank account number.

After receipt of the application the FCRA division may send a questionnaire asking for a few clarifications and the applicant organisation should submit an answer. The MHA requires the following supplementary information for processing the Prior Permission application:

1. The bank account number through which foreign contribution is proposed to be received.
2. A copy of the Project Report for the amount proposed to be received giving concrete details and expenditure according to items with supporting documents if any, showing how the foreign contribution is proposed to be utilised, the specific area/region to be covered and the time frame during which it is envisaged to be utilised.
3. A copy of the donor's commitment letter offering financial assistance to your organisation.
4. Whether the association is owner/printer/publisher/editor of any newspaper or magazine, registered under the Press Book Registration Act, 1867.
5. Whether your organisation ever applied for registration under the FCRA. If so, the date of sending the application for registration and the latest reference, if any, received by you from the Ministry.
6. Whether your organisation ever received foreign contribution without getting registered under the FCRA or without getting Prior Permission. If so, full particulars of remittances received along with complete address of the bank branch and Bank account number.
7. A brief report on the activities of the association stating the year it began, details of concrete work done giving details of funds received each year, sources of receipts during each calendar year and the manner of their utilisation by your organisation during the last five years.
8. Names and addresses of the beneficiaries and the specific region(s)/ area(s) covered by the projects.
9. Whether your organisation has obtained clearance from the nodal ministry. If so, a photostat copy of their clearance letter.
10. Whether the foreign donor is a private organisation or a foreign Government or its agency. In cases where the donor is a foreign Government or its agency, you are advised to furnish the following additional information:
  - a. A detailed report on how the aid is to be used, the specific geographical area to be covered, the time frame envisaged etc.

- b. A copy of the letter from its foreign Mission in India agreeing to give assistance along with a certificate by the Mission that necessary clearance has been obtained from the Ministry of External Affairs.
- 11. Names and addresses of the Governing Body members/office bearers of the Association.

Normally, the MHA gets the claims of the applicant organisation about its activities verified through its sources before taking a decision as to whether or not to grant registration under FCRA.

The time limit for disposing the application is 90 days from the date of receipt of the application.

However, in case of special difficulty in disposing the application the Central Government can take another 30 days and inform the applicant.

If the application is not disposed of within 90 days or an extended period of 120 days, the applicant can take it for granted that Prior Permission is given. However, to be on the safe side, the applicant organisation should obtain confirmation about the grant or refusal of permission because the MHA may not be responsible for postal delays in the communication of orders.

#### **9.1.10. Maintenance of Accounts**

##### **i) Books of Accounts**

###### **a) Cash Contribution:**

A separate set of books of accounts must be maintained exclusively for foreign contribution received and utilised.

A Cash Book and Ledger must be maintained in the double entry system of book-keeping.

###### **b) Contribution In kind :**

In respect of foreign contribution received in kind such as articles, vehicles, medicines etc., the accounts must be maintained in Form No. FC-6 prescribed in the rules, (see Appendix 2).

In respect of foreign securities if any, the accounts shall be maintained in Form FC-7 prescribed in the rules, (see Appendix 2).

##### **ii) Bank Account**

Only one bank account should be maintained and operated exclusively for receipt of foreign contribution.

The details of such a bank account should have been informed to the FCRA division while making the application for registration or Prior Permission and it

should have been specified in the Registration letter or Prior Permission order by the FCRA Division of the MHA.

If the organisation wants to change the designated bank account then a fresh application in Form FC-8 must be made justifying the reasons necessitating such a change.

After receipt of the above permission the new account can be operated. However as soon as the change of bank account is obtained the old account should be closed and the remaining amount in it be transferred to the new bank account.

No local contribution should be transacted through this bank account. Similarly, no funds should be transferred to any other bank account maintained for local contribution.

### iii) Financial Year

The accounts for foreign contribution shall be maintained for the financial year beginning from 1st April to 31st March both for cash and contributions in-kind.

#### 9.1.11. Audit

Every organisation in receipt of foreign contribution must get its accounts audited by a Chartered Accountant.

The auditor has to certify and issue the following reports:

- i. Intimation of Foreign Contribution in Form No.FC-3, (see Appendix 2),
- ii. Balance Sheet as on 31st March,
- iii. Statement of Receipts and Payments account for the year ending 31st March.

Though the FCRA rules do not specifically require the preparation of an Income and Expenditure Account, the same should be prepared and be certified by the auditor. In fact a Balance Sheet cannot be prepared without preparing an Income and Expenditure Account. The auditor also has to review the records including Form No.FC-6, (the Articles Account) and certify the receipt and utilisation of foreign contributions in kind such as vehicles, medicines etc. The foreign contribution in kind has to be reported through Form No.FC-3 and be reflected in the Balance Sheet and also in the Receipts and Payments Account.

#### 9.1.12. Filing Returns to the Government

Every organisation in receipt of foreign contribution must furnish to The Secretary, FCRA Division, Ministry of Home Affairs, Government of India, Lok Nayak Bhavan, New Delhi 110 003, the following in duplicate:



- i. Form FC-3 duly signed by the chief functionary and certified by the Chartered Accountant,
- ii. The Balance sheet as on 31st March,
- iii. The Receipts and Payments Account for the year ended 31st March,
- iv. A list of contributions in kind and the utilisation thereof.

Though the rules do not specifically require it, it is advisable to submit the following additional reports also:

- i. The Income and Expenditure account for the year ended 31st March,
- ii. A narrative report of the activities of the organisation.

It is also advisable to provide a break up of expenses exceeding Rs.1 lakh for better clarity.

If the organisation has remitted foreign contribution to other organisations the name of the recipient organisation and its FCRA number should be furnished.

The returns are scrutinised by the officers of the MHA who may call for further details or clarification from the concerned association. This must be attended to on a priority basis and the requisite information should be furnished to the officer by name who has raised these queries, giving the reference number of the MHA letter.

#### **9.1.13. Time Limit for Filing the Return**

The time limit for filing the FC-3 and the related documents referred to in the previous section (9.1.12), is 60 days from the closure of the financial year. The financial year ends on 31st March and hence the last date for furnishing the return to the Ministry of Home Affairs is 30th May following the 31st March of the same calendar year.

#### **9.1.14. Implications of Violations**

##### **i. Filing of false, delayed returns etc.**

If any association fails to furnish returns within the prescribed period or in the prescribed form, or furnishes any intimation which is false, then the Central Government can take administrative action by virtue of powers conferred under the proviso to section 6(1) of the Act and suspend registration under FCRA. This means that the defaulter association can accept foreign contribution only after obtaining Prior Permission from the day the association is notified under the Prior Permission category in the official Gazette. It is thus imperative to furnish all the returns to the Government in the prescribed manner and within the prescribed time period. It should also be ensured that no false information is furnished in the returns. If any association receives foreign contribution through any branch

of a bank other than the one which is authorised by the Central Government then it will also invite similar action and the Central Government can place the association under the Prior Permission category.

In addition to the aforesaid administrative action, prosecution u/s.25 of the Act can also be initiated by the Central Government for non-compliance with any of the other provisions of this Act and in these cases imprisonment up to a period of one year or a fine up to Rs.1,000/- or both can be imposed by the court.

#### **ii. Receipt of Foreign Contribution on Behalf of Another Unregistered Association**

If any association assists another association which is neither registered under FCRA nor has obtained Prior Permission in the acceptance of foreign contribution, then both the associations i.e. the donor and the donee can be prosecuted u/s.23(1) of the Act which provides for a maximum penalty of imprisonment up to five years. Therefore, associations which are registered under FCRA should ensure that no amount of foreign contribution is transferred by them to any other association which is not registered under FCRA without Prior Permission having been obtained by the recipient association. Besides this penal action, the association registered under FCRA can also be placed under Prior Permission category by invoking powers conferred u/s.10(b) of the Act, in the public interest, and the recipient association can even be prohibited by the Central Government, in the public interest, by invoking powers conferred u/s.10(a) of the Act.

#### **iii. Subsequent Publication of Newspaper etc., Registered under Press and Registration of Books Act, 1867**

If any association which is registered under FCRA starts printing or publishing or editing etc., a registered newspaper/magazine, subsequent to the grant of registration under FCRA by the Central Government, then it automatically comes under the prohibited category by virtue of section 4(1)(b) of the Act. Associations which are registered under FCRA are therefore advised not to start any such publication etc.

#### **iv. Associations Engaging in Activities of a Political Nature**

Voluntary associations should not involve themselves in any political activity. If any association, whether registered or not, engages itself in political activities which the Central Government considers to be of a political nature because of the type of activities engaged in by the organisation, the ideology propagated by the association, the programmes of the organisation or their links with the activities of any political party, the association will then be notified under the

Prior Permission category by virtue of powers conferred u/s 5(1) of the Act. After an association is so notified in the official Gazette, it cannot thereafter, receive any foreign contribution without the Prior Permission of the Central Government.

**v. Inspection of Accounts or Records**

If the Central Government has any reasonable ground to suspect that any provision of the Act is being violated or has been violated by any association, then it can authorise any gazetted officer holding a group 'A' post to inspect any account or records maintained by such an association. During the course of inspection if the authorised officer has a reasonable cause to believe that any provision of this Act or any other law relating to foreign exchange has been contravened, then he/she can seize such accounts or records. However, if no action is initiated against the association within six months from the date of such seizure then those records are required to be returned to the association. Powers of inspection have been conferred by the Act u/s 14. Central Government can even have an audit of the accounts of any association carried out if the return is not furnished within the specified time period or if it is not in accordance with the law or there is reasonable apprehension that any provision of this Act has been or is being contravened by the association.

**vi. Receipt of Foreign Contribution in Contravention of the Provisions of the Act - Seizure of Articles or Currency**

If any association accepts or obtains any article or currency, whether Indian or foreign in contravention of the provisions of the Act or without registration under FCRA or without seeking Prior Permission of the Central Government, then the currency etc. so obtained can be seized by the Central Government by virtue of powers conferred u/s 16 of the Act. For confiscation of the seized currency/articles, the Central Government will have to file an application for adjudication proceedings before the local Court of Session in the area where the seizure has been made. Besides this, the Central Government can also pass orders u/s 12 of the Act prohibiting payment, transfer, delivery or any other dealing with such article or currency which has been obtained in contravention of the provisions of the Act by any association.

**vii. Delayed or Incomplete Returns**

Under section 15A if any organisation has delayed in furnishing any returns or such returns are not in accordance with the law and if the Central Government believes that any provision has been contravened then it will order a special audit of accounts of the organisation.

**viii. Possession of any Article in Contravention of FCRA**

Under section 16 if any person is found to be in possession of any article exceeding Rs.1,000/- in value, or any currency in contravention of the Act, then the Central Government may seize such an article or currency.

Under section 18 of the Act, the article or currency can also be confiscated. Where an article or currency liable for confiscation is not available, an additional fine not exceeding five times the value of the article or currency, or one thousand rupees, whichever is more, shall be imposed under section 24 of the Act.

**ix. Accepting or Assisting to Accept Foreign Contribution in Contravention of FCRA**

Under section 23 of the Act the penalty for the above action is imprisonment for a term which may extend up to five years, or a fine, or both.

Under section 25 of the Act the penalty for offences where no separate punishment is provided for is imprisonment for a term of one year or a fine exceeding Rs.1,000/-, or both.

**9.1.15 Safeguards Against Vindictive/Arbitrary Action by the Authorities**

Neither the Foreign Contribution (Regulation) Act, 1976 nor the rules framed in it provide for observance of principles of natural justice. However, it has been held by the Apex Court and various High Courts that any administrative action which involves civil consequences must be preceded with a reasonable opportunity of hearing. Therefore, if any action is to be initiated by the Government under the provisions of FCRA, an opportunity of hearing has to be offered to the concerned association. This opportunity may not be in the shape of a formal show-cause notice and it is sufficient if the lapses are pointed out by the concerned authority to the association. On this point, there are a large number of cases and even High Court decisions involving administrative action under the provisions of FCRA wherein it has been held that the rule of *audi alteram partem* must be strictly adhered to. Some of these cases are W.P.No.9677 of 1986 and W.P.No.12901/87 both of Comprehensive Rural Operations Service Society, Hyderabad - Vs. - Union of India (A.P.High Court decision); W.P.No.5118 of 1988, Rural Development Trust, Anantapur - Vs.- Union of India (A.P.High Court decision); C.C.A.No.99/88 AWARE, Hyderabad - Vs. - Union of India (A.P.High Court decision); W.P.No.16613/86, Christian Institute for the Study of Religion and Society, Bangalore - Vs. - Union of India (Karnataka High Court decision).

**9.1.16. Check - list for Registration under FCRA**

1. Open a bank account separately and designate it specifically for receiving foreign contribution.
2. Fill up form FC-8 fully and completely.
3. Attach all the enclosures referred to in Form No.FC-8.
4. Ensure the application is signed by the Chief Functionary.
5. Mail the application by Registered Post with Acknowledgement Due to the following address:  
The Secretary  
FCRA Division  
Ministry of Home Affairs  
Lok Nayak Bhavan  
Khan Market  
NEW DELHI 110 003.
6. As soon as any questionnaire or queries are sent, reply quickly, giving the reference number of the MHA letter.
7. Cooperate with the enquiring officer, if any, by explaining the activities of the organisation and convincing him or her of the need for registration.
8. It is wise to preserve the postal acknowledgement received from the FCRA division and then to send a reminder if there is any undue delay in receiving a reply from them.
9. Do not operate the designated bank account until the registration is obtained.

**9.1.17. Check - list for Prior Permission**

1. Open a bank account separately and designate it specifically for receiving foreign contribution.
2. Fill up form FC-1A or FC-1 as the case may be, in full.
3. Attach all the enclosures referred to in the above application form.
4. Ensure the application is signed by the Chief Functionary.
5. Mail the application by Registered Post with Acknowledgement Due to the following address:  
The Secretary  
FCRA Division  
Ministry of Home Affairs  
Lok Nayak Bhavan  
Khan Market  
NEW DELHI 110 003
6. As soon as any queries are asked or a questionnaire is sent, reply immediately.
7. Cooperate with the enquiring officer, if any, by explaining the activities of the organisation and convincing him or her of the need for Prior Permission.
8. Preserve the postal acknowledgement received from the FCRA division so that the time limit of 90 days or 120 days can be determined.
9. Do not operate the designated bank account until the Prior Permission is received or the time limit of 90 days or 120 days has expired whichever the case may be.
10. Even if 90 days or 120 days are over it is advisable to wait for a few more days in case of postal delays and then confirm the result of the application for Prior Permission.

**9.1.18. Check - list for form No. FC- 3**

1. It is to be submitted by the organisation signed by the Chief Functionary and certified by the Chartered Accountant.
2. The FCRA registration number or Prior Permission number should always be quoted in the forwarding letter or on the top of the FC-3 form.
3. Forms have to be filled up in all respects and nothing should be left incomplete.
4. Each receipt of foreign contribution must be checked with reference to the entry in the FC-3 (list of receipts in part II), and the credit in the bank account. Each receipt must be reflected separately and all the prescribed columns should be completed.
5. The Grand Total as in column no.16 of part II of FC-3 should tally with the total under the current receipts of Part III of FC-3.
6. Part III in the FC-3 should be filled up correctly with reference to the opening balance, current receipts, utilisation and closing balance under each head of account viz. according to purpose.
7. The closing balance in Column No.21 of Part III of FC-3 must tally with the closing balance as per the Cash Book viz. Cash on hand + Cash at the designated bank + Fixed Deposits if any.
8. Disclose the interest earned on Fixed Deposits and the Savings Bank Account of Foreign Contribution in FC-3 in a separate column.
9. In case of disbursement to other organisations attach a list with the FC-3 itself giving the details of such disbursements along with the names and addresses of the recipients and their registration particulars with the MHA.
10. Form FC-3 has to be submitted to the Ministry of Home Affairs for the year ending 31st March, on or before 30th May of the same year.
11. Attach the break up details of the closing balance viz. Cash on hand + Cash at bank + Fixed Deposits of Foreign Contribution as at 31st March along with Form No.FC-3.
12. Attach an annual report, (a brief report of the activities of the organisation).

## 9.1.19 QUERIES AND ANSWERS DOCUMENT

### Foreign Contribution (Regulation) Act, 1976

#### Legal entity and Registration

- Q1. A non-profit organisation wants to execute a project with foreign funds through another organisation. How to go about this without violating FCRA?

*Ans. The second organisation should obtain Prior Permission or registration before the first organisation passes on any funds. However the first organisation can execute the project in its own name without passing on any funds.*

- Q2. Can an organisation without a legal entity make an application for registration?

*Ans. Yes, however it is preferable to incorporate the organisation as a legal body and then apply for registration.*

- Q3. Our society is registered for carrying out social service activities but we are not registered under FCRA. Can it receive certain project grants from foreign countries through another organisation which is having FCRA registration?

*Ans. No. You can not receive through another organisation. You have to obtain either registration or Prior Permission to receive the grants.*

- Q4. Our organisation though not registered as a legal entity, is registered under FCRA for receiving foreign grants. What are the implications of this?

*Ans. There are no implications under FCRA. However the Income Tax Department may not grant registration under section 12A because the organisation is not a legal entity and consequently the organisation cannot obtain tax exemption.*

- Q5. Can an organisation receive foreign funds on filing an application for registration before the registration is obtained?

*Ans. No. Foreign contribution can be received only after the registration is obtained.*

- Q6. Is there any time limit for the Government to grant registration after an application for registration is made?

*Ans. No. The Act has not prescribed any time limit for granting or rejecting the registration application. However it has been held by the Karnataka*



High Court in the case of "New Life Computer Institute versus Union of India" that the Government should dispose off the application within a reasonable time limit.

### Bank account

Q7. Is it possible to change a bank account designated under FCRA? If so, how to go about it?

Ans. Yes, you can change the bank account designated under FCRA.

To do so follow the steps below :

- Open a bank account by depositing only the minimum amount required to do so.
- Ensure that no FC is deposited in this account until permission from the Ministry of Home Affairs is received.
- Apply to the MHA for permission to change the bank account to FCRA in Form No.FC-8.
- Write a covering letter explaining that you are already registered and you need only a change of bank account. Explain the circumstances which have necessitated such a change. (This is to avoid any misunderstanding that you are unregistered).
- Enclose along with form No.FC-8 the following :
  - i. A copy of the registration certificate
  - ii. Memorandum of Association
- As soon as the permission is received, transfer the entire balance in the old FCRA account to the new account.
- After the entire balance is transferred close the old account.
- Inform the Ministry of Home Affairs about the closure of the old account and enclose a certificate of closure from the bank.

Q8. Can an organisation have more than one bank account under FCRA?

Ans. No, however in the case of projects or programmes which are far away from the head quarters of the organisation and therefore it is not convenient to carry cash from the head quarters to the project's location, another bank account may be opened exclusively for utilisation. Normally the Ministry of Home Affairs does not allow more than one bank account to be opened under FCRA.

Q9. We receive funds from various funding agencies. After crediting them in the FCRA designated bank account can we transfer them to different bank accounts to be opened for each agency?

Ans. No. Unless the programme locations are far away from the main office, funds should not be transferred to various bank accounts.

**Transfer of Funds**

Q10. If local contribution (LC) and Foreign Contribution (FC) are mixed is it a violation under FCRA?

*Ans. Yes. It is a serious violation of the Act and could lead to cancellation of registration.*

Q11. Will the advancing of local contribution (LC) to FC and vice versa amount to mixing of funds?

*Ans. Yes, and it could lead to cancellation of registration.*

Q12. Can I transfer the interest earned in an FC Bank account or in a fixed deposit (FD) made out of FC to the local account?

*Ans. No. Interest earned on foreign contribution is deemed to be FC and hence has to be credited in the foreign contribution account only.*

**Deemed Export**

Q13. Do assets acquired under the Deemed Export Scheme need to be reported under FCRA? If yes, then how to account for and report the transactions?

*Ans. Yes, they do have to be reported under FCRA. The assets have to be accounted for in form FC-6 (Articles account) and reported in FC-3 and also reflected in the Balance Sheet.*

Q14. How to account for Deemed Export and other contribution received in kind under FCRA?

*Ans. Deemed Export and other foreign contributions in kind has to be accounted in Form No.F.C.6, reported through FC-3 and if they are assets they should be reflected in the Balance Sheet.*

**Assets**

Q15. How to account for sale of assets acquired through foreign contribution?

*Ans. The sale proceeds of assets acquired originally out of foreign contribution should again be credited to the foreign contribution account and reduced from the relevant asset item in the Balance Sheet.*

Q16. Should depreciation be charged on fixed assets in the Foreign Contribution Balance Sheet?

*Ans. Depreciation is a non-cash expenditure representing wear and tear of the fixed assets though no cash outflow is involved. However in order to reflect the true and fair value of the asset it is advisable to charge depreciation. This depreciation shall be deducted from the original cost of the asset and debited in the income and expenditure account.*

Q17. In the case of an organisation which serves the public e.g. Housing programme for the poor, construction of community halls, digging of wells etc., how are these assets, (houses, halls, wells), reflected in the FCRA accounting and reporting?

*Ans. Since these assets are for the use of the public they can be shown as utilisation in FC-3 and they need not be reflected as assets in the assets side of the Balance Sheet. In such cases the title should not normally be held in the name of the organisation. However a list of such assets can be attached along with the FC-3 returns.*

#### Loans

Q18. If grants from a foreign source are delayed for a project then can the funds be advanced from other projects?

*Ans. Yes, but if it is from a foreign donation then only with the consent of the donor and not otherwise. However it is not advisable to advance from local funds.*

Q19. Can an organisation give a loan from its foreign contribution to another organisation?

*Ans. Since any donation, delivery or transfer of foreign fund is defined as foreign contribution, a loan to another organisation will amount to acceptance of foreign contribution by the latter organisation. The recipient organisation therefore needs to be registered under FCRA. The consent of the funding agency is also required for giving a loan.*

Q20. How to account for funds received for a Revolving Fund?

*Ans. If the fund is given as a loan it has to be reflected in the closing balance in FC-3 and as assets in the Balance Sheet. However if the funds are given as a grant such grants have to be shown as utilisation in the accounts.*

#### Investments

Q21. Can foreign contributions be invested in fixed deposits with banks and other securities?

*Ans. Funds not immediately required for the activity of any project can be invested in fixed deposits or such other investments as are allowed under law (section 11(5) of the Income Tax Act 1961 and under the relevant provisions of the Societies Registration Act.*

Q22. Should the income from the above investments be shown in the FC account?

*Ans: Yes, it should be shown in the Foreign Contribution Account.*

Q23. Can an organisation receive corpus donations? If yes, how can they be invested?

*Ans. Yes, an organisation can receive corpus donations. Such donations can be invested in any approved investments as provided under section 11(5) of the Income Tax Act.*

#### Time limit

Q24. Is there a time limit for disposal of an application for Prior Permission?

*Ans. An Application for Prior Permission has to be disposed off within 90 days by the MHA. However the Government may ask for another 30 days and hence totally 120 days.*

Q25. What is the time limit for filing the annual return?

*Ans. The time limit for filing the annual return is 60 days after the close of the financial year.*

#### Surrender of Registration

Q26. Can an organisation surrender its FCRA registration?

*Ans. Yes. However there should be a resolution of the Governing Body stating the decision made to surrender its FCRA registration. If there is any transfer of assets or money then the transfer has to be to an organisation registered under FCRA.*

Q27. We are an organisation registered under FCRA but we have had no transactions for 3 years. What should we do?

*Ans. File a nil return every year in Form No.FC-3 even if there is no receipt of foreign contribution. If you do not plan to revive the organisation then you may surrender the FCRA registration.*

#### Others

Q28. Can an Organisation change or enhance its aims and objectives? if so what is the procedure followed under FCRA?

*Ans. Yes, the organisation should inform MHA about the change or enhancement of its aims and objectives through a letter. No form is prescribed for this purpose.*

- Q29. Do funds received by a non-profit organisation from Non-Resident Indians through NRE/NRO/FCNR accounts need to be reported under FCRA?  
*Ans. Generally not, but it is safer to credit such funds in the FCRA account since an NRI can be a citizen of India or a foreign citizen. In the case of an NRI who is a Foreign citizen any contribution is treated as foreign contribution under FCRA.*
- Q30. Can funds received for one purpose be used for another purpose?  
*Ans. No, if it does have to be used for another purpose, consent of the donor must be obtained first.*
- Q31. If funds received for one purpose are used for another purpose, will it amount to diversion and what is the implication under FCRA?  
*Ans. If funds received for one purpose are used for another purpose without the donor's consent it will lead to cancellation of the FCRA registration.*
- Q32. How much foreign contribution can an individual receive without attracting FCRA?  
*Ans. An individual can receive any amount of foreign contribution for his/her personal purpose e.g. a personal gift. However he/she can become liable under the provisions of the Income Tax Act, 1961 and Gift Tax Act, 1958.*
- Q33. Can foreign contribution received in the name of individuals be encashed by the organisation?  
*Ans. Yes, if the individual has received the foreign contribution on behalf of the organisation. If the money is received as a personal gift then the provisions of FCRA do not apply.*
- Q34. In the case of an organisation having programmes and projects at different units, how should the balance of cash and advances available in the units be treated?  
*Ans. All such balances in the units must be incorporated in the closing balance available at the main office and be reported to the Ministry of Home Affairs in Form No.FC-3 and in the Balance Sheet.*

## 9.2. Income Tax Act

Of the Direct Tax Laws, it is the provisions of Income Tax Act, 1961 which has serious repercussions on non-profit organisations. This Act, though generally expressed as applicable to trusts, equally applies to societies registered under the Societies Registration Act, Companies incorporated under section 25 of the Companies Act, and other such non-profit organisations.

This Act is a charging legislation which means it levies tax on the income of the institution. Although the Act provides various types of exemptions, non-compliance of any of the provisions shall result in huge payment of taxes draining the scarce resources of the organisation and dislocating its activities.

### 9.2.1. Applicability

This Act applies to all non-profit organisations whether charitable, religious or voluntary, development organisations or whatever name they are called.

There is a wrong notion that non-profit organisations are automatically tax exempt since they exist for charitable, religious or development work and not for making profit.

### 9.2.2. Types of Exemption

Broadly there are two types of exemption available under the Income Tax Act for non-profit organisations:

1. Total Exemption
2. Annual (Conditional) Exemption

### 9.2.3. Total Exemption

There are certain institutions which are eligible for special exemptions e.g. schools, colleges, hospitals. These are otherwise known as total exemptions.

These exemptions are granted for a period longer than one year. The following are the various types of total exemption available:

#### a) Educational Institutions

There is an exclusive total exemption from income tax for educational institutions and universities provided that:

- i. The institution, university or any other educational institution should solely and totally exist for educational purposes and not for purposes of profit.
- ii. The institution should not exist for profit which means any surplus should not be appropriated by any trustee(s) or any one else for personal purposes. On the other hand it does not mean no surplus should be

earned. Any surplus generated should be ploughed back or reinvested for educational activity.

This exemption has to be obtained from the local Income Tax Officer under whose jurisdiction the institution falls by making a specific claim for total exemption and filing the audited financial statements.

There is no specific form prescribed for this purpose and hence the claim has to be made in writing.

This exemption is not automatic and hence the institution cannot unilaterally presume that it is exempt. On the other hand after making the claim, a spoken order has to be obtained from the Income Tax Officer stating that the institution is exempt u/s.10(22) of the Act.

Once this exemption is obtained it is valid until it is revoked. Though it is not mandatory to file the return every year, the audited statements have to be filed with the Income Tax Department for obtaining or renewing exemption. In view of the above, it is advisable to file the return every year.

#### **b) Medical Institutions**

The income of a medical institution is entitled for an exclusive total exemption if the following two conditions are satisfied:

- i. The institution should be a hospital or any other institution which treats and rehabilitates the sick and the mentally handicapped,
- ii. It should exist for philanthropic purposes and not for the purpose of profit which means any surplus should not be misappropriated by the trustees or anyone else. On the other hand it does not mean no surplus should be arising out of the activity but the surplus generated should be ploughed back and reinvested for the activities mentioned in (i) above.

This exemption has to be obtained from the local income tax officer under whose jurisdiction the institution falls by making a claim and filing the audited financial statements.

There is no specific form prescribed for making this application and hence the claim has to be made in writing.

This exemption is not automatic and therefore the institution cannot unilaterally presume that it is exempt. On the other hand after filing the return and making the claim, a spoken order has to be obtained from the Income Tax Officer that the institution is exempt u/s.10(22A) of the Act.

Once this exemption is obtained it is valid until it is revoked. After obtaining this exemption once, the audited financial statements have to be filed for obtaining

or renewing exemption u/s 80G of the Income Tax Act. Therefore it is advisable to file the return and there is no harm in doing so.

Many hospitals and medical institutions in the country are exempted under this section.

#### **c) General Charitable Institution**

Section 10(23C)(iv) provides total exemption for an organisation carrying on different charitable activities e.g. educational, medical and other social service activities but not entitled for total exemption under section 10(22) or 10(22A). It should be an institution of importance throughout India or a state. This exemption is given for a period of three assessment years at a time if the following conditions are satisfied:

- i. that it applies or accumulates its income wholly and exclusively to the objects for which it is established.
- ii. that it will invest its funds in accordance with section 11(5) of the Income Tax Act 1961.
- iii. that in the case of business conducted by the institution -
  - a. The business is incidental to the attainment of its objectives.
  - b. Separate books of account are maintained for such business.

#### **d) Public Religious Institutions:**

Many large religious organisations are notified under section 10(23C) (v) of the Act as being totally tax exempt.

This section provides total exemption for any institution wholly for public religious purposes or for public religious and charitable purposes for a period of three years at a time to be renewed thereafter if the following conditions are satisfied:

- i. the manner in which the affairs of the institution are administrated and supervised should ensure that the income is applied to the objects thereof.
- ii. that it applies or accumulates its income wholly and exclusively to the objects for which it is established.
- iii. that it will invest its funds in accordance with section 11(5) of the Income Tax Act 1961.
- iv. that in the case of business conducted by the institution -
  - a. The business is incidental to the attainment of its objectives.
  - b. Separate books of account are maintained for such business.



#### **9.2.4 Annual (Conditional) Exemption**

Some institutions do not fall under any of the above categories of total exemptions due to the following reasons; that they are —

- i. not exclusively carrying on educational or medical activities but other charitable activities also e.g. a society runs a school, a dispensary and also a social service activity. Hence this society as a whole may not be eligible for educational or medical exemption.
- ii. not institutions of national or state importance though they are institutions established for carrying on charitable activities.

In respect of such public, charitable or religious institutions the Income Tax Act grants exemption under section 11 of the Act.

#### **a) Conditions for Obtaining Annual Exemption**

##### **1. Registration under section 12 A**

- a. The Trust or institution claiming exemption under sections 11 to 13 of the Act should get itself registered with the Commissioner of Income Tax within a period of one year from the date of creation of the trust or establishment of the institution.
- b. The above application for registration has to be made in Form No.10A, (see appendix 3), along with two photo copies of the Deed of Trust or Memorandum of Association. The application has to be made in duplicate.
- c. If there is a delay in making the application beyond a period of one year, the Commissioner of Income Tax has discretion to condone the delay and admit the application and grant registration if the institution was prevented by sufficient cause from filing the application in time.

##### **2. Audit**

In order to be entitled for exemption u/s.11 to 13 of the Act, the trust or institution must have its accounts audited if its total income computed under the Income Tax Act without giving effect to the provisions of sections 11 and 12 exceeds Rs.25,000/- in the previous year.

##### **3. Investment of Funds**

All the funds of a non-profit organisation, whether charitable or religious, should be invested in accordance with the provisions of section 11(5) of the Income Tax Act, 1961 in the following manner :

- i. Investments in savings certificates or any other securities issued by the Central Government.
- ii. Deposits in any account with the Post Office or a scheduled Bank.
- iii. Deposits in any account with a scheduled bank or a co-operative society engaged in banking.
- iv. Investments in the Unit Trust of India.
- v. Investments in any security for money created and issued by the Central Government or State Government.
- vi. Investments in any debentures issued by a company or corporation where both the principal thereof and the interest thereon are fully and unconditionally guaranteed by the Central Government or by State Government.
- vii. Investments in any Public Sector company.
- viii. Deposits with any Bonds issued by a financial corporation engaged in providing long term finance for industrial development in India.
- ix. Deposits with any Bonds issued by a Public Company formed with the main object of carrying on the business of providing long term finance for construction or purchase of houses for residential purposes.
- x. Investments in immovable property.
- xi. Deposits with the Industrial Development Bank of India.
- xii. Investments issued under any scheme of the mutual fund referred to u/s 10(23D).
- xiii. Any transfer of deposits to the Public Account of India.

Any investments made in violation of the above provisions will result in the organisation losing tax exemption on its entire income.

**b) Manner of Claiming Exemption:**

**1. By spending 75% during the year etc.**

- a. If the trust or institution has applied the entire income of the year for charitable or religious purposes, the whole of the income shall be exempt from tax.
- b. Even if only 75% of the income is applied for charitable or religious purposes during the year then the balance 25% shall be automatically accumulated u/s.11(1)(a) of the Act, and the whole of the income shall be exempt from tax. In otherwords at least 75% of the income shall be applied for its purposes during the year.

**2. By accumulating and spending in the next year etc.**

- a. If the trust is not able to apply even 75% of the income because income accrued has not actually been received, then the short fall can be made good during the next year in which the income has been actually received.
- b. On the other hand, if the trust is not able to spend even 75% of the income during the year due to any reason other than not receiving the income, then the trust can spend such income during the immediately succeeding year and still claim the exemption in respect of the entire income for the year.
- c. The option mentioned above has to be made in writing to the Income Tax officer within the time allowed for filing the Return of Income. There is no specific form prescribed for making the above application.

**3. By accumulating for a period of ten years**

- a. If the trust is not able to fulfill any of the conditions and has not applied 75% of the income for the year, nor been able to spend in the next year, there is yet another possibility to claim exemption by accumulating or setting apart the income of the trust for a specific purpose(s) for a period not exceeding ten years.
- b. This has to be done by filing an application, (form No.10), as prescribed under the Income Tax Rules on or before the last date for filing the return of income. There is provision for condonation of delay.
- c. Along with the above form a copy of the resolution passed by the institution for accumulating such income should also be enclosed. The above resolution should specify the purpose(s) for which the income has been accumulated or set apart.
- d. The income set apart as above has to be invested in accordance with the provisions of section 11(5) of the Income Tax Act.

**c) Filing of Return of Income :**

The return of income for the above institutions has to be filed on or before 31st October of each year where an audit is compulsory. Where there is no compulsory audit i.e. where the income is below Rs. 25,000, it has to be filed on or before 30th June.

The following documents have to be filed along with the return:

- a. Form 3A provided by the Income Tax Department
- b. Audited Financial Statements
  - Receipts and Payments Account

- Income and Expenditure Account
  - Balance Sheet
- c. Audit Report in Form 10B certified by the Auditor
  - d. Copy of certificate of registration under section 12A
  - e. Copy of certificate of exemption under section 80G
  - f. In the case of accumulation for one year, an application (no format prescribed)
  - g. In the case of accumulation for 10 years, an application in Form No.10 and a resolution of the Governing Body.

#### **9.2.5. Denial of Exemption Under Section 11 Under Certain Circumstances**

The exemption u/s.11 shall be denied in the following cases:

1. When any part of the income from the property is held under a trust for private religious purposes which is not for the benefit of the public, section 13(1)(a).

2. In the case of a Trust for charitable purposes created after the commencement of the Income Tax Act, 1961 if the Trust or institution is created or established for the benefit of any particular religious community or caste.

3. In the case of a Trust or Institution established after the commencement of the Act, if any part of such income or property of the Trust or Institution is used or applied directly or indirectly for the benefit of any person referred to in section 13(2) namely the Author of the Trust, the founder of the Trust or Institution or any person who has made a substantial contribution to the Institution namely exceeding Rs.25,000/- during the year section 13(1)(c).

4. However in the case of an institution established before the commencement of the Income Tax Act, 1961 the restrictions contained in the previous paragraph shall not apply if such use or application is by way of compliance with a mandatory term of the trust or the rule governing the institution.

#### **9.2.6. Income Under Income Tax and Real Income**

The concept of computation of income under various heads of which some are notional in nature does not apply to taxation of charitable and religious institutions.

Income for the purposes of taxability of the above trusts is real income available for application for the objects of the trust.

**9.2.7. Voluntary Contributions and Corpus Donations:**

While voluntary contributions received without any specific direction are considered to be income, those contributions received with a specific direction that they shall form part of the corpus of the trust though considered as income, are exempt u/s 11(d) of the Act.

**9.2.8. Business Income of the Charitable and Religious Trust Section 11(4-A):**

The Trust can commence and run business and be entitled to tax exemption of business income if —

1. the business is incidental to the attainment of the main objectives.
2. a separate set of books of accounts is maintained for the above purpose.

**9.2.9. Taxability of Capital Gains Section 11(IA):**

Where capital gains arise on the sale of a property of an organisation and if the entire net sale price is utilised in acquiring another new capital asset the whole of the capital gains shall be exempt.

If, on the other hand, only a portion of the net sale price is utilised then proportionate capital gains shall be exempt.

**9.2.10. Relief to Donor****1. 50% Relief**

Under section 80G of the Income Tax Act, where a person makes a donation in the form of money to a charitable institution (not religious) such a donation will qualify for deduction under the Act up to 10% of the gross total income (as reduced by any portion thereof on which income tax is not payable under chapter vi A of the I.T. Act) of the donor. Such donations should be of a minimum of Rs.250/-. Where such donations are made, the donor is entitled to claim deduction from taxable income to an extent of 50% of the donations.

**2. 100% Relief**

Further the Government also provides 100% deduction for a business organisations if they contribute for the following purposes and fulfill certain conditions.

- i. Expenditure on scientific research and donations made for research in social science (section 35)
- ii. Payments made to associations and institutions for carrying out rural development programmes (section 35 CCA)
- iii. Payments made to associations and institutions for carrying out programmes of conservation of natural resources (section 35 CCB)

**9.2.11. Allotment of Permanent Account Number (PAN)**

Section 139 A provides for the allotment of a Permanent Account Number to every person who is required to furnish a return of income.

The Income Tax officer may allot the Permanent Account Number (PAN) which must be quoted:

- at the time of filing the return of income
- at the time of any correspondence with Income Tax authorities
- in all challans for payment of any sum due under this Act.

The Institution will have to make an application in Form No. 49A in duplicate for allotment of PAN.

**9.2.12. Tax Deduction Account Number (TAN)**

Every institution deducting tax at source also has to obtain a Tax Deduction Account Number called in short TAN. This can be obtained by filing Form No. 49B with the concerned Income Tax Officer.

The challan for payment of the tax deduction can be obtained from the Income Tax Department by making an application in Form No. 17 with the Income Tax Department and paying Rs.25/- to the Reserve Bank of India or the local treasury.

The tax deduction account number should be quoted:

- in all certificates issued in accordance with the provisions of the Act like tax deducted at source certificates issued to employees on their salaries or payments made to contractors.
- in all the returns that are submitted to the income tax authority for tax deducted at source.

**9.2.13. Tax Deduction at Source (TDS)****i. Types of Payments Subjected to TDS:**

Tax has to be deducted and paid to the Income Tax Department of the Government of India from the following payments:

- Payment of Salaries to staff
- Payment to Contractors and Sub-contractors

Persons making the above payments, have to strictly deduct the tax at certain rates and pay the same to the Income Tax Department. Charitable, religious and non-profit organisations have already been required to deduct tax from payments like salaries, interest etc. However up to 31st of May 1992, the above

institutions were not legally required to deduct tax at source from payments made to contractors and sub-contractors.

By an amendment to the Income Tax Act, from 1st June 1992, the above institutions have also been required to deduct tax at source from payments to contractors and sub-contractors.

#### **ii. Tax Deduction at Source on Salaries:**

An organisation is required to deduct tax at source on salaries above the taxable limit of its employees under section 192 of the Act after allowing deduction and tax rebates as stipulated under the provisions of the Act.

The amount so deducted shall be remitted within one week from the last day of the month in which deduction is made.

The annual return for tax deducted at source from salaries shall be filed on or before May 31st in Form No.24.

In the case of employees leaving service a statement in Form No.21 shall be filed within one month from the end of the month in which an employee leaves service.

#### **iii. Tax Deduction at Source on Payment to Contractors**

Payments to contractors and sub-contractors include payment for any work including supply of labour for carrying out any work in pursuance of a contract between the contractor and the institution. Payments also include the advances made towards bills and mobilisation advances. Payments to contractors can be from any source whether local or foreign contribution. However, payments do not include the amounts paid for materials like cement, bricks etc. if the bills for the materials are in the name of the institution.

#### **iv. Rate of Tax**

Tax has to be deducted @ 2% on the payment to the contractors and at 1% from payment to sub-contractors. There is a surcharge on the above tax rate which is 12% for non-company contractors such as individuals and partnerships and 15% for contractors who are limited companies. Hence deduction for non-company contractors is 2.24% and for contractors who are companies it is 2.30%.

Tax has to be deducted only from payments exceeding Rs.10,000/- on a particular contract. Therefore, on contracts whose value is below Rs.10,000/- there is no need to deduct tax at source.

After deducting the tax the same has to be remitted into a bank through a challan provided by the Income Tax Department to the credit of the Central

Government. Thereafter a certificate to the contractor in Form No.16B has to be issued.

The tax deducted has to be paid to the Central Government within two months from the last date of the month in which the deduction is made. For instance, if the deduction is made on 28 February 1994, the tax has to be paid to the Central Government on or before 30 April 1994.

#### v. Annual Returns

The annual return in Form No. 26C has to be filed on or before 30th of June for the fiscal year ending 31st March of each year.

#### 9.2.14. Loans and Deposits

##### i. Acceptance of loans and deposits

Under the provisions of section 269SS of the Income Tax Act an organisation shall accept or take any loan or deposit or from any other person by account payee cheque or demand draft only if the amount of such loan or deposit or the aggregate of such loan or deposit is rupees twenty thousand or more.

##### ii. Repayment of deposits

Under the provisions of section 269T of the Income Tax Act an organisation shall repay any deposit made with it to any other person by account payee cheque or account payee demand draft only if:

- a. the amount of such deposit together with interest if any, payable thereon or
- b. the aggregate amount of such deposits with interest held by such person is rupees twenty thousand or more.

#### 9.2.15. Implications of Violations

Violations of the provisions of the Income Tax Act attract tax, interest, penalty and prosecution as below:

- In case the return of income of non-profit organisations as stipulated in the Act is not filed in time, the organisation is likely to be levied tax and interest thereon.
- The consequences of failure to deduct or pay tax deducted by an organisation is that interest will be leviable at 15% p.a.
- An organisation is liable to penalty if it fails to deduct tax at source in whole or in part. The amount of penalty that is likely to be levied is a sum equal to the amount of tax after affording a reasonable opportunity to the organisation.



- An organisation which accepts loans or deposits, or repays deposits in cash exceeding the stipulated amount which is discussed under respective heads then the penalty leviable will be equivalent to the amount of the loan or deposit accepted or repaid. The levy of penalty is subject to the explanations on violation by the organisation.
- Failure to pay tax deducted at source into the credit of Central Government will attract prosecution.
- Failure to produce accounts and documents at the time of hearing will attract prosecution.

## **9.3. Other Acts**

### **9.3.1. Applicability of Wealth Tax Act**

Under section 5(1)(i) of the Wealth Tax Act, property held under trust or other legal obligation for charitable or religious purposes in India shall not be included in the net wealth of the assesseees.

Hence if a non-profit organisation is exempted under any of the provisions of the Income Tax Act it shall be automatically exempt under the Wealth Tax Act.

However, the above exemption shall not apply to property forming part of business other than that which is referred to in section (4A) of section 11 of the Act.

Property forming part of business carried on by an institutions, funds or Trusts referred to in clauses 22, 22A, or 23C of section 10 I.T. Act shall continue to be exempt.

If any part of the income or property is used for the benefit of the persons mentioned in section 13(3) of the Income Tax Act then the Wealth Tax shall be levied on the property of the Trust as if on an individual.

### **9.3.2. Applicability of Gift Tax Act:**

No gift tax shall be charged in respect of gifts made as under:

- i. To any institution or fund established or deemed to be established for a charitable purpose to which the provisions of section 80G of the Income Tax Act 1961 applies.
- ii. To such temple, mosque, gurdwara, church or other place as has been notified by the Central Government for the purpose of clause (b) of subsection (2) of section 80G of the Income Tax Act, 1961.

- iii. For any charitable purposes not covered above at a time not exceeding Rs.100/- and to the same donee during the previous year not exceeding Rs.500/-.

#### 9.3.3. Other Laws

The above discussion covers only the major laws and rules. However there are many other laws e.g.:

- i. Land ceiling Acts
- ii. Urban/Agricultural land Tax Acts
- iii. Property Tax
- iv. Professional Tax
- v. Laws relating to staff welfare (P.F., Gratuity)

It is advisable to consult a legal expert for the applicability of various laws and their compliance in the case of a particular organisation.

#### 9.4. Check - list to Claim Exemption u/s.10(23c)(iv) and 10(23c)(v) of the Income Tax Act 1961

1. Make six copies of Form No.56 (see appendix 3) and fill up the same.
2. Complete the enclosures as follows :
  - a. Certificate of registration for legal entity
  - b. Memorandum of Association or Deed of Trust
  - c. List of trustees or Board members
  - d. Copy of the certificate under 80G of the Income Tax Act
  - e. Copies of the assessment orders for the past three years
  - f. Copy of the certificate of registration under section 12A of the Income Tax Act.
3. The application should be sent to the Director General (Exemptions) through the Commissioner of Income Tax having jurisdiction.
4. Any further clarification required by the Income Tax authorities should be provided.
5. Always apply for renewal at least three months ahead of the expiry of the exemption.

**9.5. Check - list for Filing the Annual Return  
To Claim Exemption u/s 11 of the I.T. Act.**

1. Fill up Form No.3A and sign the same.
2. Complete the enclosures as follows :
  - a. Memorandum of Association or Deed of Trust if it is the first year of filing the return of income
  - b. Receipts and payments account, Income and Expenditure account and Balance sheet duly attested by the office bearers and auditors
  - c. Audit Report in Form No.10B duly filled in and certified by a Chartered Accountant where the income of the institution exceeds Rs.25,000/- without giving effect to the provisions of section 11 of the I.T. Act.
  - d. If it is not able to apply 75% of the income then an option could be exercised in writing to the Income Tax officer that the income shall be spent during the immediately succeeding year with the return of income within the due date. File the same with the enclosures mentioned above.
  - e. If it is not able to apply 75% of the income during the year and it cannot spend the income during the immediately succeeding year as mentioned in (d) above then the trust can accumulate the income by filing the following with the return of income —
    1. Form No.10 duly filled in and signed
    2. Resolution passed by the institution for accumulating the income and the purpose for which it is accumulated
3. Care should be taken that the mode of investments is in accordance with the provisions of Section 11(5) of the Income Tax Act.
4. The due date for filing the return of income is as follows:
  - a. If the income of the institution other than a charitable company does not exceed Rs.25,000/- - 30th June
  - b. If the income of the institution other than a charitable company exceeds Rs.25,000/- - 31st October
  - c. For a charitable company incorporated under the Companies Act - 31st December