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PERMISSIBLE BUSINESS FOR NGOS

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INTRODUCTION & OVERVIEW

1.01 The recent amendments in the definition of 'charitable purpose' under section 2(15) may have far reaching implications on the business income of charitable organisations. It may be noted that the NGOs engaged in advancement of any other object of general public utility, **will not be allowed to have even incidental business activity beyond Rs.10 lakh turnover.** Therefore, it becomes important to know the types of commercial activities which will not be treated as business at all. It is also important to know the activity which can be considered as incidental business. In this issue various permissible and incidental business activities have

been discussed. However a brief overview of the recent amendments and the implications are provided as under :

1.02 The definition of 'charitable purpose' can be divided into 6 parts, viz. (i) relief of poor, (ii) education, (iii) medical relief, (iv) preservation of environment, (v) preservation of monuments or places or objects of artistic or historic interest, (vi) advancement of any other object of general public utility. However, the Finance Act, 2008 w.e.f. 1-4-2009 has excluded any trade, commerce or business related activity by any trust or NGO engaged in the sixth category i.e. advancement of any other object of general public utility, from the purview of

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'charitable purpose'. In other words an NGO exclusively engaged in the field of education, medical relief and relief of poor preservation of environment & preservation of monuments shall not be hit by this amendment.

1.03 Therefore, w.e.f. 01.04.2009 it seems that income from trade, commerce or business pertaining to those NGOs which are coming under the sixth category of 'charitable purpose' shall not be treated as charitable activity and the entire exemption of such Trust will be lost. Consequently such organisations will not be eligible for any exemption under section 11 or other provisions which provide exemptions towards charitable purpose. It may be noted that the issue of incidental activity of business will not be relevant to such group of NGOs. Whether the business activity is incidental or not, shall be of no consequence, as this sixth category of NGOs will lose the charitable status. However, the Finance Act, 2010 has provided some relief to the sixth category NGOs as NGOs having business activities to the extent of rupees ten lakh (receipt) will not be affected.

1.04 There is confusion that only the business income of NGOs shall become taxable at the rate of 30%. It is clarified that once an NGO is hit by this provision, it will lose its charitable status and the entire income will become taxable.

1.05 It is pertinent to note that all other NGOs (other than the NGO coming under the sixth category) can have business related activity as permitted under section 11(4A), and other provisions pertaining to business activities shall be applied without any changes.

1.06 Hitherto the law was very liberal with regard to the business activities of NGOs and even income from unrelated businesses (for example, publishing newspapers) held by them was eligible for exemption if the entire income was used for charitable purposes. The law will continue to remain

It is clarified that once an NGO is hit by this provision it will lose its charitable status and the entire income will become taxable

liberal for the first five categories of NGOs.

1.07 It is important to note that the exclusion of trade or business related activities is discriminatory and will apply to only a particular group of NGOs or Trusts as discussed above. It is not clear why a particular group of NGOs will be discriminated even though the registration provides an *on par* status to all NGOs. The resulting scenario denotes an unfair legal situation where even an incidental business activity of the sixth category NGO will render forfeiture of the charitable status. On the other hand, for other NGOs even unrelated business activities might be permissible. The constitutional validity of such unfair provision needs to be verified.

1.08 Newly inserted proviso to section 2(15) lays down the 'specified activities'. They are :

- Carrying on of any activity in the nature of trade, commerce or business (hereafter referred to as 'the trade'); or
- Carrying on of any activity of rendering any service in relation to the trade, for a fee or cess or any other consideration.

The proviso further lays down that if the specified activities are carried on in pursuit of the sixth object, then it would not be considered as a charitable purpose, if the receipts from such activities exceed rupees ten lakh per annum.

1.09 It may be noted that NGOs or trusts engaged in the sixth objective shall continue to be eligible under section 11 unless they engage in trade or business related activity.

1.10 It may also be noted that the current amendments are prohibiting business activity and not *profit making*. In other words such sixth category NGOs may still have some profit through various sources of income generation other than business or commercial activity. Therefore, going by various case laws activities such as

- charity shows,
- rent from property,
- income from Kalyana Mandapam or conferences facilities,
- business involving poor / beneficiaries etc.
- sale of books without profit motive
- organising workshop and seminars etc.

shall still be permissible and valid. The CBDT has issued an explanatory circular in this regard which is annexed herewith. The circular categorically denies even incidental business or commercial activities for the sixth category NGOs.

1.11 Micro finance activity may get impacted. It seems that organisations existing solely for providing interest bearing loans will be treated as commercial entity. However giving interest bearing loan as one of the various activity may not necessarily be a commercial activity.

1.12 Incidental business activities such as employing indigent women for stitching or tailoring, marketing products of the beneficiaries or greeting cards etc, shall be considered as activities towards achievement of the primary purpose of relief to poor and therefore,

It has been held that income from Kalyan Mandapam or the building and other fixed infrastructure used for seminars and workshops etc., shall be treated as income from house property

should not be treated as business activity, as was decided by Supreme Court in *Thiagarajar Charities and Thanti Trust case (supra)*.

1.13 The amendment to the Section 2(15) shall apply from the assessment year 2009-10.

INCOME FROM KALYAN MANDAPAM OR WORKSHOP INFRASTRUCTURE

2.01 It has been held that income from Kalyan Mandapam or the building and other fixed infrastructure used for seminars and workshops etc., shall be treated as income from house property and not as business income. The following cases may be referred, *CIT v. Samyuktha Gowda Saraswatha Sabha* [2000] 245 ITR 242 (Mad.), *CIT vs. Gordhandas Bhagwandas Charitable Trust* [2004] 136 TAXMAN 161 (MAD.)

INCOME FROM OCCASIONAL ACTIVITIES

3.01 It has been held that income from occasional activities cannot be considered

as business activity. In *CIT vs. Hyderabad Race Club Charitable Trust* [2003] 129 TAXMAN 788 (AP) it was held that activities such as running races and inter-venue betting after obtaining license from the Government cannot be considered as business activity. The Explanatory Circular No. 11/2008, F. No. 134/34//2008-TPL dated 19th December 2008 also provides that whether an activity is business or not shall be determined based on the nature, scope and frequency of the activity. In other words, the Circular also provides that occasional commercial activity will not be considered as business or commercial activity. Therefore, occasional businesses like a charity show or a mela for fund raising will not be treated as business.

BUSINESS INVOLVING POOR AND BENEFICIARIES

4.01 The Supreme Court in case *Thiagarajar Charities v. ACIT* [1997] 092 TAXMAN 152 (SC), has held that businesses involving the poor and beneficiaries cannot be said as business or activity for profit. The apex court provided two reasons (i) the business is only a 'means' of achieving the 'object' of the trust; it is a medium through which the 'objects' are accomplished. (ii) the business - corpus - property held under trust - produces or results in income, *like any other property*. In the light of this landmark decision it seems that business activities involving the beneficiaries and done only with the motive of providing relief to the poor, cannot be considered as business at all.

4.02 The issues of business activity involving poor beneficiaries were also considered by the Supreme Court in the case of *Asstt. CIT v. Thanthi Trust* [2001] 247 ITR 785, wherein the Hon'ble Supreme Court held that even the business of weaving cloth and stitching clothing by

The Supreme Court has held that businesses involving the poor and beneficiaries cannot be said as business or activity for profit

employing indigent women, carries on the business in the course of actually accomplishing its primary object of affording relief to the poor and it would qualify for the exemption under section 11.

MARKETING COMMITTEES

5.01 In another important ruling regarding commercial marketing of various products of common beneficiaries in the case *Agricultural Produce and Market Committee v. CIT* [2007] 291 ITR 419 (Bom.), it was held that the activities pertaining to marketing of agricultural produce was charitable in nature. The contention of the revenue that the activities were commercial in nature was not accepted by the Bombay High Court and it was observed that any profit or fees charged in the process of marketing could not take away charitable nature of the activity and it would still be considered as a charitable activity towards advancement of any other general public utility. This is very significant in the light of the recent amendment to section 2(15) which prohibits business activity for the NGOs engaged in advancement of any other general public utility.

MANUFACTURE AND SALE OF KHADI

6.01 In a significant ruling the Rajasthan High Court in *CIT v. Adarsh Gram Trust* [1986] 159 ITR 41 (Raj.), held that a trust with the dominant object of propagating and implementing the ideas of Mahatma Gandhi for the upliftment of poor and backward people was a charitable trust. The issue was whether an organisation for the purpose of promotion and sale of khadi can be called as a charitable organisation? The court observed that if the trust's predominant object was for charity, it was entitled to the exemption. Promotion and sale of khadi is an activity of general public utility. Therefore, it should not be treated as business or commercial activity at all.

6.02 The court held that the manufacture and sale of Khadi was an activity towards propagation of the doctrine of Mahatma Gandhi and therefore should be considered as a charitable activity.

6.03 From the above it is clear that any business run as a part of charitable activities cannot be considered as a business or commercial activity *per se*. Therefore, business activity involving employment of indigent women or poor beneficiaries will be treated as actually accomplishing the primary objects or affording relief to the poor and it would be considered as charitable activity only.

INCIDENTAL TRADING ACTIVITY NOT A BUSINESS - SALE OF BOOKS

7.01 The Supreme Court in *CST v. Sai Publication Fund* [2002] 258 ITR 70/122 Taxman 437 (SC) held that any business incidentally done as an integral part of the larger charitable purpose cannot be

The court held that the manufacture and sale of Khadi was an activity towards propagation of the doctrine of Mahatma Gandhi and therefore should be considered as a charitable activity

considered as incidental business. The Apex Court has held that if the main activity is not business, then any transaction incidental or ancillary would not normally amount to 'business' unless an independent intention to carry on 'business' in the incidental or ancillary activity is established. In such cases, the onus of proof of an independent intention to carry on 'business' connected with or incidental or ancillary to sales will rest on the department.

MANAGEMENT SEMINARS WITH HIGH FEES IS NOT BUSINESS

8.01 In the case *Indo-American Society v. ADIT (E)* [2005] 96 ITD 61 (Mum.) / [2005] 278 ITR (AT) 49 (Mum.), the Assessing Officer denied benefit of exemption under section 11 to assessee-society on ground that it was conducting educational courses in professional manner with high charges at five star hotels where only elite class could attend those courses and thus, object of society was not falling within 'general public utility' category. The issue before the Tribunal was that since dominant object of conducting seminars and class-room programmes by assessee-society was to

impart education; such programmes were conducted with desire to do good work and not to earn profit; and fee was charged to meet cost, it could not be construed to be business of assessee-society. The Tribunal held that such activity could not be considered as business activity. The Tribunal held that there was nothing to support that the educational programme were being done with an intention to earn profit. Therefore even if it was for the elite class, it cannot be considered as business activity and should be treated as a part of charitable purpose.

PERIPHERAL BUSINESS ACTIVITY CANNOT AFFECT EXEMPTION

9.01 In the case *DIT(E) v. Agri-Horticultural Society* [2005] 273 ITR 198 (Mad.) it was held that various peripheral activities including sale of seeds, flower pots or even higher charges for shooting of commercial films would not justify withdrawal of exemption because various receipts were received for activities undertaken without any commercial motive.

MICRO FINANCE AND MONEY LENDING ACTIVITY

10.01 The Micro Finance activity may be hit by the recent section 2(15) amendments. In the Departmental Circular No. 100 [F.No. 195/1/72-IT(A-1)] dated 24.01.1973 the issue of money lending and interest bearing loan has been discussed. This circular is in context of loan given to students for higher education. It has been

Micro Finance Institutions solely existing for providing interest bearing loans may not be treated as charitable activities unless such institution proves that its activities are towards relief of poor.

clarified that even interest bearing loan given to the students would be treated as activity towards advancement of the objectives, provided giving interest bearing loan is not the only activity of the organisation. From the circular the following issues are apparent :

- (i) Interest bearing loan *per se* is not necessarily a commercial activity unless the sole objective of the organisation is to provide interest bearing loan. In that case it will be treated as money lending activity.
- (ii) If a portion of activity of an NGO involves providing interest bearing loan to needy beneficiaries, it may still be considered as an activity towards advancement of charitable objectives and may not be treated as business activity at all.
- (iii) Even loan taken for the purposes of trust can be repaid as valid application and such loan may be used for advancing loan to needy beneficiaries.

10.02 The circular was issued in context of educational loan for higher studies, but it provides the ratio and the legal rationale for treatment of Micro finance activity as charitable activity or money lending

activity. Micro Finance Institutions solely existing for providing interest bearing loans may not be treated as charitable activities unless such institution proves that its activities are towards relief of poor. Therefore, unless the interest rates are highly subsidised it may not be treated as charitable activity.

THE CIRCULAR NO. 11, DATED 19TH DEC, 2008 APPLICABLE ONLY TO MASKED ENTITIES

11.01The CBDT had issued the above mentioned circular (*Annexed herewith*) clarifying the circumstances in which business activity of NGOs will be prohibited. The circular clearly states that the amendments were primarily made with the intention of curbing the misuse of the Income Tax exemptions by masked entities. In this regard it was held by Himachal Pradesh Tribunal that the amendments should apply to masked entities only. In other words, only those entities which are not genuine NGOs should suffer. In the case *Himachal Pradesh Environment Protection and Pollution Control Board v. CIT* [2009] 125 TTJ 98(CHD.) the Tribunal observed that the applicability of the circular No. 11, dated 19th Dec, 2008 (2009) 221 CTR (St) on the proviso to Explanation section 2(15) can only be pressed into service when pursuing objects of 'general public utility' is only a mask to cover the "true purpose" of "trade, business or commerce, or rendering of any service in relation to such trade, business or commerce".

11.02However, the income tax act does not speak about masked entities and normally a circular can not go beyond what is stated in the statute. It can only clarify or provide guidelines.

In effect the Supreme Court held that any business would be incidental provided its income are applied for charitable purposes.

SUPREME COURT ON INCIDENTAL BUSINESS

12.01The Hon'ble Supreme Court has held that a business activity should be considered as incidental if the entire income is used for charitable purposes. In effect the Supreme Court held that any business would be incidental provided its income is applied for charitable purposes. Such a wide interpretation of the term 'incidental' also has contributed to the recent amendments. In the case *Asstt CIT Vs Thanti trust (2001)247 ITR 785(SC)*, the Supreme Court had given a landmark decision wherein it was held that if the income generated from a business is totally used for charitable purposes then such business should be considered as incidental. In this case, the assessee was having the business of publishing newspaper and the entire income was used for charitable purposes.

12.02In our opinion the legal and judicial position (as taken in *Thanti case*) should remain intact as far as the business or trade related income is concerned, even after the amendments made by Finance Act, 2008 w.e.f. 1-4-2009. The controversy is around the nature of charitable purpose which a trust is pursuing if it does not fall in the category of (i) relief of poor, (ii) education, (iii) medical relief, (iv)

preservation of environment, (v) preservation of monuments or places or objects of artistic or historic interest, then any trade or business related activity whether incidental or not shall result in revocation of the entire exemption. Further, even in the sixth category business activity to the extent of Rupees Ten Lakh is permissible w.e.f. 01.04.2011.

12.03 Therefore, after this amendment if *Thanti Trust* is having activities which falls in the sixth category i.e. *advancement of any other object of general public utility*, then it will no longer be considered as a charitable organisation. Similarly, in a recent case *CIT vs. Gujarat Maritime Board* [2008] 214 CTR (SC) 81, 295 ITR 561 (SC) it was held that the income earned and deployed for the development of the minor ports in India was a charitable activity and therefore, the Gujarat Maritime Board would continue to remain a 'charitable trust'. Now after the amendment, if *Gujarat Maritime Board* is holding independent business activity whose profit feed the charitable work then the exemption will be lost. On the other hand, if some profits are generated during the normal course of its charitable activity, then its charitable existence will remain intact because *Gujarat Maritime Board* is clearly a sixth category charitable organisation. However, the analysis will be different for a medical, educational or an NGO engaged in relief for poor, who are not hit by the recent amendments.

BUSINESS PURPOSE VS ACTUAL BUSINESS ACTIVITY

13.01 It should be noted that the recent amendments have been made in the section defining charitable purpose.

The question arises whether the provisions of section 2(15) will be attracted even if there is a clause pertaining to business activities in the memorandum or trust deed

Therefore, the question arises whether the provisions of section 2(15) will be attracted even if there is a clause pertaining to business activities in the memorandum or trust deed. In other words, do NGOs need to amend their object clause and delete the business related clauses from their Memorandum of Association or Trust Deeds to avoid the attraction of section 2(15) since there will be a possibility of questioning the charitable nature of an NGO even if it does not have any actual business related activities. However, it has been held that only the existence of other objects cannot affect the charitable status of a Trust or NGOs, *Digamber Jain Society for Child Welfare vs. DGIT (Exemptions)* [2010] 228 CTR (Del) 517.

In *Ewing Christian College Society v. Chief Commissioner of Income-tax* [2009] 318 ITR 160 (ALL.), it was held that the objective to serve the church and nation would not mean that the society was not existing solely for educational purposes. In this case the petitioner-society was running various educational institutions in State of Uttar Pradesh. In this case the court relied on the Supreme Court ruling in *American Hotel and Lodging Association Educational Institute* [2008] 301 ITR 86 SC.

CIRCULAR ON CHARITABLE PURPOSE' UNDER SECTION 2(15)

Circular No. 11/2008, F. No.134/34//2008-TPL
 Government of India, Ministry of Finance, Department of Revenue
 Central Board of Direct Taxes, (Tax Policy & Legislation Division)
 New Delhi, the 19th December, 2008

1. Section 2(15) of the Income-tax Act, 1961 ('Act') defines "charitable purpose" to include the following :—

- (i) Relief of the poor
- (ii) Education
- (iii) Medical relief, and
- (iv) The advancement of any other object of general public utility.

An entity with a charitable object of the above nature was eligible for exemption from tax under section 11 or alternatively under section 10(23C) of the Act. However, it was seen that a number of entities who were engaged in commercial activities were also claiming exemption on the ground that such activities were for the advancement of objects of general public utility in terms of the fourth limb of the definition of 'charitable purpose'. Therefore, section 2(15) was amended *vide* Finance Act, 2008 by adding a proviso which states that the 'advancement of any other object of general public utility' shall not be a charitable purpose if it involves the carrying on of—

- (a) any activity in the nature of trade, commerce or business; or
- (b) any activity of rendering any service in relation to any trade, commerce or business; for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention of the income from such activity.

2. The following implications arise from this amendment.

2.1 The newly inserted proviso to section 2(15) will not apply in respect of the first three limbs of section 2(15), *i.e.*, relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute 'charitable purpose' even if it incidentally involves the carrying on of commercial activities.

2.2 'Relief of the poor' encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity, subject, however, to the conditions stipulated under section 11(4A) or the seventh proviso to section 10(23C) which are that :—

- (i) the business should be incidental to the attainment of the objectives of the entity, and
- (ii) separate books of account should be maintained in respect of such business.

Similarly, entities whose object is 'education' or 'medical relief' would also continue to be eligible for exemption as charitable institutions even if they incidentally carry on a commercial activity subject to the conditions mentioned above.

3. The newly inserted proviso to section 2(15) will apply only to entities whose purpose is 'advancement of any other object of general public utility' *i.e.*, the fourth limb of the definition of 'charitable purpose'

contained in section 2(15). Hence, such entities will not be eligible for exemption under section 11 or under section 10(23C) of the Act if they carry on commercial activities. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity.

3.1 There are industry and trade associations who claim exemption from tax under section 11 on the ground that their objects are for charitable purpose as these are covered under ‘any other object of general public utility’. Under the principle of mutuality, if trading takes place between persons who are associated together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants. Therefore, *where industry or trade associations claim both to be charitable institutions as well as mutual organizations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality.* However, if such organizations have dealings with non-members, their claim to be charitable organizations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

3.2 In the final analysis, however, whether the assessee has for its object ‘the advancement of any other object of general public utility’ is a question of fact. If such assessee is engaged in any activity in the nature of trade, commerce or business or renders any service in relation to trade, commerce or business, it would not be entitled to claim that its object is charitable purpose. In such a case, the object of ‘general public utility’ will be only a mask or a device to hide the true purpose which is trade, commerce or business or the rendering of any service in relation to trade, commerce or business. Each case would, therefore, be decided on its own facts and no generalization is possible. Assessee, who claim that their object is ‘charitable purpose’ within the meaning of section 2(15), would be well advised to eschew any activity which is in the nature of trade, commerce or business or the rendering of any service in relation to any trade, commerce or business.

(Pradip Mehrotra)
Director (TPL-I)

**DEPARTMENTAL CIRCULAR NO. 100 [F.NO. 195/1/72-IT(A-1)]
DATED 24.01.1973**

Repayment of debt incurred for purposes of trust/loans advanced by educational trusts to students for higher studies - Whether amounts to application of income.

1. Section 11 requires 100 per cent of the income of a charitable and religious trust to be applied for religious and charitable purposes to be entitled to the exemption under the said section. Two questions have been considered regarding the application of income.

- (i) Where a trust incurs a debt for the purposes of the trust, whether the repayment of the debt would amount to an application of the income for the purposes of the trust; and
- (ii) Whether loans advanced by an educational trust to students for higher studies would be treated as application of income for charitable purposes.

2. *The Board has decided that repayment of the loan originally taken to fulfil one of the objects of the trust will amount to an application of the income for charitable and religious purposes. As regards the loans advanced for higher studies, if the only object of the trust is to give interest-bearing loans for higher studies, it will amount to carrying on of money-lending business. If, however, the object of the trust is advancement of education and granting of scholarship loans as only one of the activities carried on for the fulfilment of the objectives of the trust, granting of loans, even if interest-bearing, will amount to the application of income for charitable purposes. As and when the loan is returned to the trust, it will be treated as income of that year.*

Reference Book : **Taxation of Trust and NGOs with FCRA and FEMA, 5th Edition 2010** by **Manoj Fogla**, published by TAXMANN Publications, New Delhi

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