

Evaluation of Non-Profit Organizations in India: A Reform Experience

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Abstract

Through the years, Institutions and Trusts have received special privileges by the Indian Government in the form of deductions and exemptions. However with the advent of the Direct Tax Code, the Government seeks to decrease its leniency towards these Non-Profit Organisations (NPOs). The findings of this study provide valuable information regarding NPOs commercialization, indicating that an understanding of the non-profit concept in relation to internal and external customers must be incorporated into the commercialization process. Social loafing is a sensitive topic in organizational research, particularly for NPOs without HR professionals. This study recommends that NPOs use Lean-management tools to reduce operational management issues caused by various social loafing situations. Further interdisciplinary, integrated research on the commercialization of NPOs of various types should be conducted to clarify concerns regarding the overall NPO commercialization environment. In this articles the authors has discussed various issues, challenges, suggestions and recommendations required for nonprofit organizations.

KEYWORDS: NPOs, Direct tax code, Charity, NGOs

INTRODUCTION

The issue of tax reform has been engaging the Indian voluntary sector for many years, in spite of the fact that the voluntary sector has been able to utilize less of the tax concessions offered by the government while the private foundations have utilized every rule in the book [1]. It may be imperative to understand the tax structure of the nonprofit organisations. There is also a registration to receive foreign money which is outside the tax machinery and controlled by the Home Ministry within the government. A non-profit organization may also be registered as a company under section 25 of the Indian Companies Act 1956, which is federal legislation. Such companies are known as 'section25 companies' [2].

EMERGING ISSUES

Presently, the main issue is that there are certified self-regulatory bodies like the Institute for Auditors or the Bar Association for a lawyer which is also an NGO in a sense. They regulate their members. This helps audit professionals and lawyers to maintain the credibility. In the NGO sector there is or hardly any self-regulation making it easier for tax authorities to apply their own discretion an interpretation [3].

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The second issue is that of validation which is very similar to what CRISIL (a rating agency for companies) does in India [4]. It is the objective to certify non-profit organisations which meet the minimum criteria of financial management and accountability. From this limited point of view, we can try and go to a broader area of self-regulation and self-discipline. NGOs are not differentiated and vary from region to region in India [5]. Further, there is no single uniform in system. This causes the bulk of the sector to gravitate from any form of self-regulation. Lack of self-regulation and lack of objective validation exposes the NGO sector to negative attacks from the media thus giving the overall sector a bad name and not highlighting the good work that goes on under very difficult circumstances. The taxman does not appreciate this and incentives are difficult for several NGO's.

The government at the same time has also been not helpful and have also constantly been changing the definition of development [6]. It is about reordering social relations, power relations, resources for poor people, all of which are within the government policy. It is not alien to the government thinking- there is joint forest management, water shed development, community managing education, local village governance etc... When we talk about tax regulation we have to find out why the NGOs are in the development process. On the other hand, if we are going to get the NGO's to be only efficient and honest, and they should be that, that is not why we want the NGOs to partner the government. India has a long tradition of NGO action. At one time NGOs were not only talking of welfare, they are now talking of major changes in governance. A task force was set up by the Government of India to look at these issues which culminated from a long discussion on tax

issues affecting the sector [7].

These issues are still not appreciated by the government much less by the tax authorities and as a result tax exemptions become more and more difficult for the real cutting edge NGO's and the ones working for genuine change amongst the poor.

Income tax laws in India: An overview

The Income Tax Act 1961 is federal legislation that affects all NGOs (trust, society or section 25 companies) uniformly throughout India. It treats all of them equally in terms of exempting their income and in granting a certificate under section 80G whereby donors to the NGOs may claim a tax rebate against donations made. Of the 298 sections of this Act, only a few sections 2(15), 10, 11, 12, 13, 35 and 80G are of special importance to NGOs.

An important principle under the Income Tax Act is that NGOs in India that have a public charitable purpose are not liable for any income tax, provided certain conditions required in law are fulfilled. These conditions include the following.

- The NGO must use 75 per cent (60 per cent under the proposed new Bill) of its income in any financial year (1 April to 31 March) on the objects of the organization. If the organization is unable to spend 75 per cent of its income in the financial year, owing to late receipt of income or for any other reason, the trustees may spend the surplus during the immediately following 12 months (under the new Bill, this has been reduced to just three months). Surplus income can also be accumulated for a period ranging from one to ten years for specific projects (under the new Bill, this provision has been dropped) [8].

- The funds of the NGO are deposited according to the forms and modes specified under section 11(5) of the Income Tax Act. (Under the proposed new Bill, the limited choice offered under this section has been further circumscribed by omitting the investment of funds in industrial development or credit banks, housing finance corporations and mutual funds.) [9]
- No part of the income or property of the NGO is used or applied, directly or indirectly, for the benefit of the founder, trustee, relative of the founder or trustee or a person who has contributed in excess of Rs50,000 to the organization in a financial year.
- The NGO files its return of income annually within the prescribed time limit.

Corpus fund:

Corpus donations are capital contributions and should be ignored when computing the total income of the organization. They should be held as corpus or capital of the trust and should not be spent like any other income (although any interest or dividend derived from the investment of such donations may be used on the objects or operation of the NGO). The accounts of the organization should reflect this position clearly [10].

The direction for the donation, whatever the amount are to be applied to the corpus of the organization can be given only by the donor. Such a direction should be given in writing. (Under the proposed new Bill, a cash contribution received (ie other than in kind or by crossed cheque or crossed bank draft) towards the corpus of the NGO will be deemed to be a contribution otherwise than towards the corpus of the trust, regardless of the donor's intended use of the

donation [11]. Income received through cash collection boxes at temples, churches, hospitals or schools will be treated as 'income' (and not as 'capital receipt'), regardless of any indication put on or near the collection boxes that contributions are towards the corpus. Therefore, 60 per cent of the amount will have to be used for charitable purposes.)

If the NGO accepts membership fees, all life membership subscriptions and entrance fees (being a collection from members and in the nature of capital receipt and not for any specific service) may be taken as capital -- and therefore not treated as income for the purpose of computing total income. People paying such membership fees and subscriptions, however, cannot deem them to be a 'donation' and claim a rebate under section 80G [12].

Business income:

Under section 11(4A) of the Income Tax Act 1961 (as amended with effect from 1 April 1992), if the income from business is incidental to the attainment of the NGO's objects and separate books of accounts are maintained by the organization in respect of such business, the profit is not considered for taxation. For example, the profit from the sale of goods produced by the beneficiaries during their training is fully exempt from tax.

Income from a business undertaking that is itself held in trust for charitable purpose is also exempt (section 11(1)(a)).

Furthermore, an activity resulting in profit need not always be treated as business. For example, hiring out halls (whether for private or public functions) or rest houses (ie subsidized accommodation for travelers or pilgrims, or

sanatoria or convalescent homes) by NGOs is not regarded as business.

Capital gains:

If an NGO sells its capital asset, capital gain arising on such sale is not liable to tax if the net sale proceeds are invested in the purchase of a new capital asset. Such re-investments should, as far as possible, be made during the same accounting year.

Disqualification from exemption:

All private religious trusts and NGOs created after 1 April 1962 that are for the benefit of any particular religious community or caste are not eligible for tax exemption (sections 11 and 12 of the Income Tax Act). However, an NGO for the benefit of scheduled castes, backward classes, scheduled tribes, women or children is not considered an organization for a particular religious community or caste and therefore its income is exempt. This is based on the separation of Charitable organisation and religious organisations.

Special exemption for certain institutions:

The income of certain NGOs engaged in activities pertaining to scientific research, education, charitable hospitals, etc, is exempt from payment of tax by various provisions contained in a group of clauses of section 10 of the Income Tax Act.

Organizations exempt under the clauses of section 10 enjoy various benefits. For example, a charitable hospital or medical institution approved under section 10(23C)(iii)(a), (iii)(b) or (iii)(c) of the Finance No 2 Act 1998 or an educational institution approved under section 10(23C)(iii)(a), (iii)(b) or (iii)(c) of the 1998 Act need not use 75 per cent of its income during the financial year on the objects of the organization. The special exemption

provides much more operational freedom.

TAX REBATE FOR DONORS

Section 80G

Donors: whether individuals, associations, companies, etc -

- are entitled to a deduction (in computing their total income) if they make a donation to an NGO enjoying exemption under section 80G of the Income Tax Act. The amount donated should not, however, exceed 10 per cent of the donor's gross total income after subtracting allowable deductions (other than the deduction under section 80G) for the purpose of tax rebate. Even if the donation is in excess of 10 per cent of the donor's gross total income, only the 10 per cent can be considered for deduction under this section.

In order to qualify for exemption under section 80G, the NGO must be a wholly charitable (not religious), recognized, tax-exempt institution and should not be for the benefit of any particular religious community or caste. An NGO exclusively for the benefit of any particular religious community or caste may, however, create a separate 'women and children fund'. Donations given to this fund could qualify for deduction under section 80G, even though the organization as a whole may be for the exclusive benefit of only a particular religious community or caste. However, a separate account must be maintained of the funds received and disbursed for the welfare of women and children.

Receipts issued to donors by NGOs should bear the number and date of the 80G certificate and indicate the period for which the certificate is valid.

Section 35AC:

Section 35AC was inserted in the Income Tax Act

1961 by the Finance (No 2) Act 1991 and came into force on 1 April 1992.

Contribution(s) made to a project or scheme notified as an eligible project or scheme for the purpose of section 35AC of the Income Tax Act entitle the donor (individual, institution or company) to a 100 per cent deduction of the amount of the contribution.

Unlike the certificate granted under section 80G (whereby a donation made to a qualifying organization entitles the donor to a 50 per cent deduction), the certificate under section 35AC is not given to any organization as a whole, but only to an eligible and approved project or to an eligible and approved project of an organization.

Eligible projects and schemes for exemption under section 35AC include one or more of the following.

- Construction and maintenance of drinking water projects in rural areas and in urban slums, including installation of pump-sets, digging of wells, tube-wells and laying of pipes for the supply of drinking water.
- Construction of dwelling units for the economically weaker sections of society.
- Construction of school buildings, primarily for children belonging to the economically weaker sections of society.
- Establishment and running of non-conventional and renewable source of energy systems.
- Construction and maintenance of bridges, public highways and other roads.
- Pollution-control projects.
- Promotion of sports.
- Any other programme for the uplift of the rural poor or urban slum dwellers, as the national committee may consider fit for support, including:

-- family welfare and immunization; tree plantation; social forestry; development of irrigation resources; rural sanitation (construction of low-cost latrines); medical camps in rural areas; rural health programmes; land development and reclamation of waste land or degraded land, with special emphasis on ecological improvement; soil and water conservation, including harvesting of run-off water; non-formal education and literacy, especially for women and children; rural non-farm activities; creation of employment opportunities for urban and rural populations living below the poverty line; supportive services for women to engage in productive work (care of children of working women by providing an improved environment, care and food and by establishing creches/balwadis, etc); and leprosy eradication.

Section 35(1)(ii) and (iii):

A deduction of 100 per cent is allowed to donors for contribution(s) made to organizations -- such as a scientific research institute or a university, college or other institution

-- approved under section 35(1)(ii) specifically for 'scientific research', and under section 35(1)(iii) specifically for 'research in social science or statistical research'.

An organization approved under section 35(1)(ii) or 35(1)(iii) must maintain a separate account of the money received by it for scientific research or for research in social science or statistical research. It must also submit to the prescribed authority, each financial year, a copy of the audited annual return, showing the total income and expenditure and a balance sheet indicating its assets and liabilities.

CONCLUDING REMARKS

In our estimation, the sector in India needs to use the available exemptions before asking for further concessions. The NGO sector needs to achieve a fair amount of self-regulation and a degree of accountability so that there is a level of comfort within and outside the sector. Some of these steps like validation, rating will help in determining the organisation's net worth and will enhance credibility for the sector. Tax concessions will then be automatic. However the driving force for this change must be within the sector rather than from an outside agency.

It is also pertinent to note that both in South Africa and India, many NGO's who are devoted to the concept of struggle and freedom from exploitation do not avail or get any tax concessions. This does not help them receive any form of local philanthropy. It gets driven to social welfare and charitable projects. Is there a mechanism that we may use tax instruments to improve the flow to such agencies which are working at the structural causes of poverty and can we be able to partner in this process.

RECOMMENDATION

The recommendations have been framed in the light of the considerations above and are set out in the following.

1. "Charity" should be distinguished from 'development' and 'training and skill development' should figure in the Law. In this connection there has been a suggestion of the CBDT that "charitable purpose" as defined in Section 2(15) of the Income Tax Act may be replaced by "charitable purpose including relief of the poor, education, medical relief, and the advancement of any other public cause or object for social environmental welfare including economic empowerment and development of the

weaker and disadvantaged sections for sustainable livelihood and social justice". This definition is of an inclusive nature, and should cover all activities of NGOs deserving public support. Accordingly, it is noted that this definition is of an inclusive nature, and should cover all activities of NGOs deserving public support. Accordingly, it recommends this definition and should be incorporated in the Act.

2. NGOs generally need to build a corpus fund for sustainability and stability of their organisations, and make efforts to obtain donations/ grants for their corpus funds after duly resolving to establish such funds. It is felt that a specific provision in the Income Tax Act is necessary allowing for NGOs to set up corpus funds and for exempting from income tax the donations/ grants received for the corpus funds including any grant to an NGO generally to support its objects.

3. Any Ngo whose gross income does not exceed the general income limit for exemption from income tax— presently Rs. 50,000 in the year--- should be exempt from income tax.

4. Further, it would be in order if deductions from taxable incomes of donors, under any provision of the income tax law, are allowed only for donations made by cheques or demand drafts on banks, Where the donor indicates his PAN (Permanent number from the Income Tax Dept), he should be entitled to 100% deduction of the donation from his taxable income.

5. The limits on the amounts of donations for the purpose of determining the exemption from income tax in the hands of the donors should be removed.

6. The present wording of Section 10 (23 C) sub clauses relating to eligibility for complete exemption for tax of all income of an NGO engaged in activities of importance to a state or the nation, needs to be modified so as to include activities which may be taken up by the NGO in a part of the state or the country in terms of the new definition of “charitable purpose” recommended above in para 4. The present wording gives room for an individual officer of the Income Tax department to apply it in a narrow manner, for instance that an NGO works only in a part of a state, and therefore cannot be considered for exemption under this section.

7. Any capital gains accruing to an NGO should be exempt from tax if it is used/applied for activities in furtherance of its objects.

8. i) The Act should be modified so that income from income generation projects of an NGO is not treated as business income attracting Section 44AB.

ii) NGOs registered under section 12 A of the Act should be entitled to receive interest on investments made by it (within the categories permitted under section 11(5) of the Act) without deduction of income tax at source on the interest amounts.

9. Section 11(2) of the Act should be modified to do away with the percentage stipulations applicable to expenditure from grants/donations received by an NGO for particular programmes or projects, so that no unspent balance is liable to tax. It should be left to the person or the agency making the grant/donation to make sure that it is spent properly.

10. Section 13(3) (b) has a monetary limit of Rs. 50,000 for the cumulative contribution to an NGO

by a person, above which he is considered a key person. All transactions with that person come under scrutiny. This monetary limit would be too low for a regular donor contributing say just Rs. 50,000 or 6,000 a year to an NGO, because in 8-10 years that donor would become a key person. Large NGOs like CRY would have to track hundreds of donors cumulative contributions for years, not knowing when any of them would cross the monetary limit. As an alternative, it can be suggested that instead of a monetary limit, say 1 per cent of the cumulative income of an NGO, or Rs. 50,000, whichever is higher, as may be stipulated. With such a small financial stake a donor will not be able to manipulate the NGO's affairs, and the intention of the law will be met.

11. Far too often the intention of the law in providing exemptions from taxable income under different sections is defeated by the delays in disposal of applications from NGOs under Section 80G, 35AC, 10(23C) etc. So, it is recommended that where an NGO's application is complete, it must be disposed off within say 60 days, or 90 days, as may be appropriate for applications under different sections, at the end of the period, the exemption sought should be taken as automatically granted, unless within that period the departmental officer raises any serious queries on any matter furnished in the application. If an application is rejected, the reasons for the rejection must be clearly specified, so that the NGO can appeal to a higher departmental authority against the rejection, or ask the first authority to review its decision.

12. It is felt that if the government amends the law on the lines recommended above, the NGOs on the other hand should accept the obligation to make public sufficient details of their affairs to enable interested people to form informed opinions of the worth of NGO's work. It is suggested that where

an NGO is given a dispensation under one or the other Section Providing for exemption of donations from income tax, or is allowed complete exemption of its income from tax, the NGO should have its accounts and the annual reports of its activities to the Tax Officer also publish in local newspapers the abridged audited accounts and a sufficiently informative reports of its activities for that year. Local people in the area of the NGO's work would be the best placed to judge how it has performed. The NGO should furnish to the tax officer copies of the material published thus in local newspapers. Failure of an NGO in this regard should automatically lead to its losing the tax exemption dispensation. This condition may not perhaps apply to NGO's which are engaged in only training, facilitation and funding support to other NGO's and have in direct activities in the field.

13. There are thousands of small localised NGO's in the country who have not registered themselves under the Income Tax Act, or field returns under the Act. They need to be helped to come into the mainstream, without attracting penalties. It is recommended that some sort of a voluntary disclosure scheme may be framed, under which they could register themselves now, and be excused from penalties for the omission to do so in the past and for not filing returns.

14. The Income Tax department should develop a database for donations by tax payers for which they claim and have been given exemptions from tax. It is necessary that this database is published and is available to researchers, the NGO community, and the general public. The database could categories donations by donations different categories of tax payers, the Sections of the Act under which exemptions have been

allowed/claimed, the categories of NGOs and the purposes/ activities for which the donations were made.

15. The officers of the Income department need to be given through orientation and training in this area of their work of administering the Income Tax Act.

16. It would be very desirable for the department to set up standing committees at the CBDT level and in the Commissioners (various IT offices), to which NGOs can represent their grievances and suggestions for improving the interfaces between the department and NGOs.

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