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141. Charitable Purpose and Income Tax

Feb-Mar '08; Released: Mar-08

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In most of the countries across the world, NPOs are exempt from Income Tax. Many countries also provide them with other incentives, such as a tax rebate on donations to charitable and religious organisations. All this is done mainly to encourage the spirit of charity. It is also justified because NPOs are often more efficient and effective in promoting welfare of the society.

As charitable organisations are exempt from tax, many others would also like to get classified as charitable, and escape paying tax. To prevent this, the law lays down strict norms and procedures.

In India, tax exemption to NPOs is available through section 10(23C) and section 11 of the Income Tax Act, 1961. The term NPO includes religious organisations (such as churches, temples, mosques, etc.) and charitable organisations (such as schools, hospitals, NGOs, etc.).

To be eligible for the exemption, a charitable organization should spend its money on 'charitable purposes'. This issue of AccountAble discusses the concept of 'charitable purpose' and the latest proposal to modify this concept.

WHAT IS CHARITABLE PURPOSE?

Charitable purpose is defined[1] in the Income Tax Act itself. According to this, four types of activities are considered charitable:

1. Relief of the Poor
2. Formal education
3. Medical Relief
4. Any other object of general public utility.

These are called four limbs of charitable purpose. Let us look at these in more detail.

1. Relief of the Poor

Any activities which directly help the poor, such

as food, shelter, clothing, emergency help etc. fall under this category. The activities must be targeted at economically poor communities.

[1] Sec. 2(15): '"Charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility;'

2. Education

The word education has a very wide meaning in ordinary usage. For tax exemption, this is mainly limited to formal schooling or training. Coaching institutions are not covered. However, education need not be given only to the poor. Also, it does not have to be provided free of charge or at lower rates.

3. Medical Relief

This covers establishment of hospitals etc. to cater to the needs of the ill. Once again, the hospitals need not cater to the poor alone or at reduced rates. However, in practice, a charitable disposition towards the needy is normally expected.

4. General Public Utility

The first three are fairly clear and easily understood by everyone. However, the fourth category is very wide and open. It can include any activity which is seen as useful and worthy of promotion by the society. A large number of modern NGOs, which are engaged in non-traditional activities such as advocacy, empowerment, social justice, and other civil society initiatives, get their exemption under this fourth limb.

BUSINESS ACTIVITIES

What happens if an NGO is also doing some business activities, to achieve its goals? For instance, an NGO may sell greeting cards and use the profits to help children or the aged. There are many NGOs which produce and sell handicrafts to generate employment. Still others are giving loans to communities through SHGs. These NGOs also recover some charges or interest. This issue has been a bone of contention between the Government and the NGO sector.

There are many NGOs which produce and sell handicrafts to generate employment. Still others are giving loans to communities through SHGs.

From 1922 till 1961, such activities were exempt from tax. The only requirement was that there should be a charitable purpose behind the activity. Charitable element (giving things free) was not an essential requirement. As a result, charitable organisations could take up any business-like activity, provided it was for a charitable purpose.

From 1961 to 1984, profit-generating activities were excluded from charitable purpose. This created a lot of hardships for charitable organisations.

Due to this, in 1984, profit-generating activities were brought back into scope of charitable activities. Some minor conditions were also imposed, which were easily fulfilled by NPOs. The definition was further relaxed in 1991.

However, in 2001, the Government was advised[2] that any NGO deriving more than 10% of its income from business profits should not be treated as a charity. It should be taxed like a business. This caused a furore – and the Government did not implement the suggestion.

At present, NGOs are allowed to take up any business-like activities. Some conditions apply[3]:

1. The business should be incidental to the main objects. This means that the business itself should not be a main object, but only a tool for achieving the main objectives.
2. Separate account books should be kept for the business activities.

The above conditions are fairly lenient and NGOs face no difficulties in meeting these.

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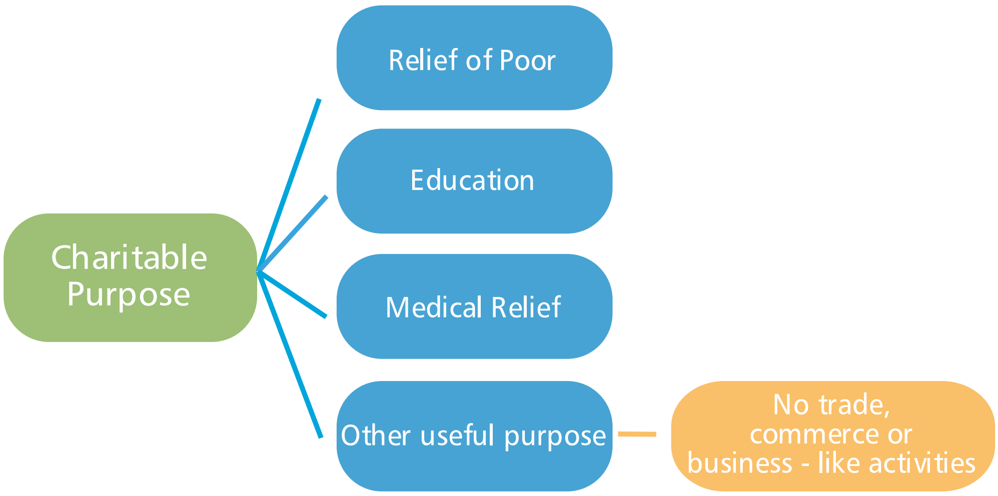
[2] Parthasarthy Shome report

[3] Section 11(4A)



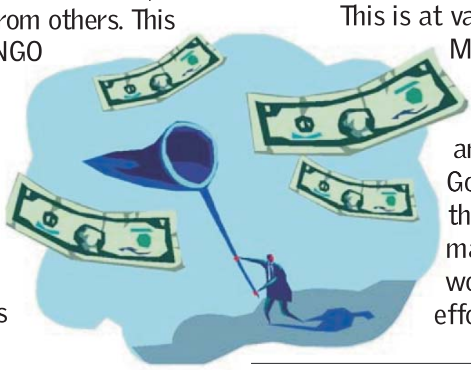
BUDGET 2008

However, there is now a proposal[4] to modify the definition of 'charitable purpose', particularly for the fourth limb.

This will mean that NGOs, which have any business-like activities, will be denied tax exemption from the coming financial year 2008-09.

This move will not affect schools or hospitals, or organizations which work for relief of the poor. Religious organizations will also not be affected, unless they have taken exemption as a charitable organization.

However, other charitable organizations will be hit hard, if they have any business-like activities, or charge any fees or consideration from others. This could even cover cases where an NGO publishes a magazine and charges subscription fees or accepts advertisements for money.



This change may affect the following kind of organizations:

1. Training organizations
2. Resource organizations
3. Human Rights organizations
4. Micro-credit organizations
5. Environmental organizations
6. Advocacy organizations
7. Research organizations
8. Chambers of Commerce
9. Professional associations
10. Fund-raising organizations
11. Networking organizations, etc.

If the amendment goes through, there will be two options for such organizations:

1. Give up any activities which can be seen as trade, business or commercial, or
2. Show that they are only working for relief of poor or are only running schools or hospitals.

If they cannot do either of the above, they may have to prepare to pay income tax from the coming financial year (2008-09).

CONCLUSION

The new amendment will end the distinction between for-profit and not-for-profit activity for a large number of NGOs. The non-traditional NGOs are more likely to be affected. At the very least, they will need to prove to the Assessing Officers that their activities do not constitute 'trade, commerce or business'.

This is at variance with the Honorable Minister's promise to the Parliament that 'genuine charitable organisations will not in any way be affected'. The Government will need to deliver on this promise to the Parliament and make sure that honest charitable work does not receive a setback in efforts to net the tax evaders.

[4] '"charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility:

Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business, or 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;'

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The Roots of Charity

We all understand what 'charitable' means, in the sense of benevolence or generosity towards others, particularly the poor. But where does this word come from? Charitable is based on the word *charity*, which has been in use in English since 1137 CE. The word had entered English from Old French, where it was spelt as *charite.*

French had borrowed this word from Latin *caritas*, meaning 'esteem, affection'. The word *caritas* is often taken to mean Christian love, as in Caritas International, a confederation of 162 Catholic organisations.

This sense emerged from the frequent use of the word *caritas* as a translation for the Greek *agape*. The word *(caritas)* had been used in the Fifth century Latin translation of Holy Bible, commonly known as the Vulgate. Agape in Greek means love, but without the romantic connotations of the Latin *amor* (as in amorous). It is perhaps for this reason that the translators used *caritas* instead of *amor.*

Caritas is pronounced as *kah-ri-tahs* (कारिटास). This led scholars to trace the roots of this Latin word back to Indo-European languages.

They found that the word *caritas* is derived from a proto Indo-European word 'karo-'. This word comes from the Indo European root *'kā'* (का). This root also forms the basis of a related Sanskrit word *kama* (कामः, desire). According to Hindu philosophy, *kama* is one of the four legitimate pursuits in human life, the other three being *dharma*, *artha*, and *moksha.*

This is another example of how words with common roots have traveled thousands of miles, and have acquired widely differing meanings!

Sources: The American Heritage® Dictionary of English Language at Bartleby.com; Online Etymology Dictionary at etymonline.com; pronunciation guide at Dictionary.com; The American Heritage® Dictionary of Indo-European Roots, Calvert Watkins, 2nd Edn. (2000).

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अकाउण्टबेल हिन्दी मे 'लेखा-योगे' के नाम से उपलब्ध है

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Printed and published by Sh. Anil Baranwal for AccountAid India, New Delhi. Ph. 26343128 and printed at Chanakya Mudrak Pvt. Ltd., New Delhi. Ph.: 41420316, 25927951
Design: Ms. Moushumi De

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