

## Income Tax in India

In India, individuals are taxed on their salaries or professional incomes. For-profit entities are taxed on their business incomes. However, nonprofit organizations (NPOs) that are established for charitable purposes are exempt from the payment of tax. The rationale is that NPOs supplement the gaps in the government's welfare and development delivery systems. The exemptions granted to NPOs, however, are subject to various conditions and regulations. Income tax is regulated by the Ministry of Finance.

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### What is the definition of “charitable purpose” under the Income Tax Act?

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Under Section 2(15) of the Income Tax Act, the term “charitable purpose” includes (1) relief of the poor; (2) education; (3) medical relief; (4) preservation of the environment (including watersheds, forests, and wildlife); (5) preservation of monuments or places or objects of artistic or historic interest; and (6) the advancement of any other object of general public utility.

Later amendments to the act made clear that “the advancement of any other object of general public utility” would not be considered a “charitable purpose” if the organization's business or commercial income exceeds 20 percent of its income from non-business sources (e.g. voluntary grants and donations). All business activity must be linked to or in furtherance of the organization's objectives.

Example: The Centre for Advancement of Philanthropy (CAP) is registered as an NPO and its income is tax exempt. Its objective is to ensure NPOs' legal compliance, and its activities include advisory services and capacity-building programs. Thus CAP falls under the category of “the advancement of any other object of general public utility.” CAP charges fees for these services. If CAP receives grants or donations amounting to 6,500,00 rupees (approximately \$100,000) in a fiscal year, it must ensure that its income from fees is not more than 1,300,000 rupees (approximately \$20,000) if it plans to remain tax exempt.

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Organizations established for “charitable purposes” are not subject to income tax, provided that certain conditions are met

### Do charitable organizations pay taxes on income?

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An important principle under the Income Tax Act is that organizations established in India for “charitable purposes” are not subject to income tax, provided that the following conditions are met.

1. The organization must use at least 85 percent of its income in any fiscal year on the charitable activities described in its charter.
2. The funds of the organization may be invested only in approved securities, as specified under Section 11(5) of the Income Tax Act.
3. No part of the income or property of the organization may be used or applied directly or indirectly for the benefit of a founder, trustee, relative of a founder or trustee, or person who has contributed more than 50,000 rupees (approximately \$770) to the organization in the course of a single fiscal year.
4. The organization must have its accounts audited and file a financial return within six months of the close of the fiscal year. In India the fiscal year runs from April 1 to March 31, so the audit and financial return must be filed by September 30.

### Are all charitable organizations exempt from tax? Are there exceptions?

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Private religious trusts and charitable organizations created after April 1, 1962 for the benefit of any particular religious community or caste are not eligible for tax exemptions. However, a charitable organization that benefits women, children, or certain marginalized classes such as forest dwellers, is not considered an organization serving a particular religious community or caste, and therefore its income is exempt.

### What if an organization is unable to spend 85 percent of its income during a fiscal year?

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In any fiscal year the organization must spend at least 85 percent of its income, which includes all donations, grants, interests, dividends, and fee receipts. For example, if the total income of the NPO is 6,500,000 rupees (approximately \$100,000) in a fiscal year, it must spend at least 5,525,000 rupees (approximately \$85,000) on charitable activities (including administrative expenses). If it fails to do so, at the time of filing the tax return or even earlier, the NPO may apply to carry the unspent income over to the next fiscal year. If the amount is very large, the organization may apply to carry over the unspent income for a period of up to five years.

### Is the organization allowed to accept corpus funds? What conditions should be fulfilled?

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Yes, an organization may accept corpus funds. Under the Income Tax Act, “corpus” means “capital.” A corpus grant is like an endowment grant. For example, if a donor simply donates 6,500 rupees (approximately \$100) to an NPO, it is accounted for as income. If the donor indicates that the 6,500 rupees are a contribution towards the corpus of the NPO, then it is accounted for not as income but as “capital.”

Corpus donations are capital contributions and should be held as the corpus or capital of the organization. To direct a donation, whatever the amount, to the corpus of the organization, a donor must provide a signed letter explicitly approving the corpus gift.

### What is the tax treatment for the “business income” of a charitable organization?

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If the income from business is incidental to the attainment of the objectives of the organization and the organization maintains separate books for the business, the profit is fully exempt from tax. Income from a business undertaking that is itself held under trust for a charitable purpose under Section 11(1)(a) of the Income Tax Act is also exempt. Further, an activity resulting in profit is not always considered income. For example, an NPO’s income from renting halls for private or public functions, rest houses, or auditoriums is not considered “business income.”

Ultimately, if the organization wishes to remain tax exempt, its business activities must be related to or further the advancement of its objectives. While it may have unrelated business activities, such activities may mean that it risks losing its tax exemption entirely.

### May an NPO invest its funds in stocks and shares?

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The investment of funds is governed by Section 11(5) of the Income Tax Act, which allows NPOs to invest their funds only in certain instruments, such as the fixed deposits of scheduled banks, units of the Unit Trust of India (a mutual fund), government securities, or deposits with certain finance corporations such as the Housing Development Finance Corporation (HDFC). Investment in immovable property is also allowed. Under Rule 17C of the Income Tax Rules, NPOs may also invest their funds in mutual funds and public sector companies.



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## May a trustee or board member receive a salary or honorarium from an NPO?

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A trustee or board member may be reimbursed for all out-of-pocket expenses. From a good governance perspective, remuneration for service as a trustee or board member is not recommended. However, the Income Tax Act provides that a salary or allowance paid to “any trustee or manager (by whatever name called)” should not “be in excess of what may be reasonably paid for such services.” This provision suggests that remuneration of trustees and board members is possible. The onus of proving “reasonableness” of salary or remuneration is on the NPO.

## May a donor claim a deduction for donations in kind?

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No. Donations in kind (such as computers, medical equipment, or vehicles) are not eligible for deductions under Section 80G. The donation must be a sum of money.

## May an NPO give a corpus donation to another NPO?

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The Finance Act of 2017 prohibits an NPO from giving to the corpus of another NPO. Program donations or grants are allowed.

## In focus: 80G Certificates - India's tool for allowing donors to claim tax deductions



### What is the benefit of having an 80G certificate?

Under Section 80G of the Income Tax Act, income tax authorities provide tax-exempt NPOs with certificates (commonly known as 80G certificates), which their donors may use to claim tax deductions.

An 80G certificate may help an NPO help attract donors. In computing their total incomes, donors (whether individuals, associations, or companies) are entitled to deductions for donations to NPOs enjoying registration under Section 80G. The amount donated, however, should not exceed 10 percent of the donor's total gross income. Any amount in excess of 10 percent of the donor's total gross income is not deductible.

### Which NPOs qualify for an 80G certificate?

To qualify for exemption under Section 80G, an NPO should be a recognized tax-exempt charity and should not exist for the benefit of any particular religious community or caste.

### How much of a deduction may a donor enjoy for making a gift to a charitable organization with an 80G certificate?

While donations made to various funds set up by the national or state government (such as the National Defense Fund, Jawaharlal Nehru Memorial Fund, Prime Minister's Drought Relief Fund, and National Foundation for Communal Harmony) qualify for a 100 percent tax deduction (that is, the whole amount donated is allowable as a deduction), donations made to non-governmental NPOs exempt under Section 80G(5) of the Income Tax Act qualify for only a 50 percent deduction.

Accordingly, in computing total income, a donor may deduct 50 percent of a donation as long as it does not exceed 10 percent of the donor's total income.

Example: If the annual income of a donor is 65,000 rupees (approximately \$1,000), the donor may give up to 6,500 rupees (approximately \$100) to enjoy a tax deduction. If the donor gives 6,500 rupees to a charity that enjoys an 80G certificate, the donor must pay tax on 65,000 rupees minus 3,250 rupees (approximately \$50) (i.e., 50 percent of the donation), or 61,750 rupees (approximately \$950).



Where can I learn more about philanthropy law in India?

More information about the Income Tax Act may be found in ICNI's India Philanthropy Law Report, which offers detailed information about the national laws and regulations affecting philanthropy in India:

<http://www.icni.org/research/Philanthropy%20Law.html>