

Shri. Pranab Mukerjee
Hon'ble Minister of Finance
Government of India
Room No – 132 C
North Block

SUBJECT: AN APPEAL FROM THE NPO SECTOR FOR RECONSIDERATION OF KEY CONCERNS IN REVISED DTC

Hon'ble Sir,

I am writing this appeal on behalf of Voluntary Action Network India (VANI). VANI is the apex body of the voluntary organizations in India. The Finance Ministry has published the revised discussion paper on the "Direct Taxes Code", which still has many provisions which will not only restrict the NPO sector but might weaken it further in future. We do appreciate the intention of the Ministry to prepare this code to streamline the direct taxation regime in the country, but for NPO sector it is quite restrictive. One hand same code provides conducive environment for the private sector but fails to understand the peculiarity of financial transaction of NPO sector.

Being part of many flagship programmes of government of India as well as due to implementation of long duration programmes, the NPOs are dependent of government funding. The code rightly recognizes this fact, that installments are generally late or many times multiple year grants are given. Even the surplus generated by NPO is under in either building schools, dispensaries or preparing educational material for marginalized. At the time of national calamities the immediate relief is also funded from such surplus. You will recognize the fact that NPOs work hand in hand in providing relief without waiting for government supply in the event of earthquakes, cyclones or floods. Unfortunately, the revised text does not provide any scope to save anything for the future of the institution. The proposed 10% savings have to be spent in three years.

Secondly, there is focus on generating local funds and reduce the dependency of country on foreign funding. That to focus is on individual donors. NPOs like Helpage, CRY and many produce, procure and sell items to generate resources for providing support to their target groups, like children, disabled or old persons, but now it seems that all that meager income meant for the marginalized and deprived will be taxed as it is defined as business activity.

Sir, we were expecting that taxation regime will be simplified and will become facilitating factor in the development of the sector, but it is heartening to see that in current form it will have adverse impact on the very existence of the sector. We do understand that there are heavy financial transactions by variety of entities registered as NPOs under the same law. We would like to urge you to see the root cause of the problems and not treat development oriented smaller NPOs along with business or religious entities like corporate hospitals, large temples, etc. We expect some differential treatment as it is provided to small, medium or large industries.

Sir, through this appeal we would humbly request you to revisit following aspects of the revised code to make it more effective and facilitating instrument. for the overall socio-economic development of the marginalized and poor and effective functioning of the NPO's across India.

The *Revised DTC* has not addressed the following key concerns:

1. **CONCERN:** Application of Income After Current Year: The *Revised DTC* has reaffirmed that the NPOs have to apply at least 90% of gross receipts or 85% of income for charitable purposes during the year of receipt which may not be practically possible.

IMPACT: It will cause undue hardship to NPOs which are unable to spend the income due to legitimate reasons such as late receipt of funds. Under the current provisions, NPOs are permitted to apply 100% of income in next 5 years if there are legitimate reasons for such non application. It may also be mentioned that the proposed provision is taking a very myopic view of development work as NPOs also engage in long term projects which extend beyond 12 months and are generally between 3 to 5 years.

RECOMMENDATION: *The NPOs be allowed to apply the Income for charitable purposes if the income is not applied, for legitimate reasons, during the year. It is imperative that the current provisions of section 11(2) and explanation to section 11(1) which provide 5 years and 1 year additional time for application of funds are restored.*

2. **CONCERN:** Accumulation of Income: The current provision of 15% indefinite accumulation has been withdrawn. The *Revised DTC* does not permit NPOs to save or accumulate even a single rupee. In other words, 100% of the income has to be utilised. Traditionally NPOs have been allowed 25% as accumulation for future. After 1st April 2002 NPOs are being permitted 15% as accumulation for future.

IMPACT: If NPOs are compelled to apply 100% of their income every year then it will affect the future sustainability of the NPO sector as the corpus will be eroded and there will be no savings to negate inflation.

RECOMMENDATION: *The NPOs be allowed to save and accumulate at least 15% of their current years income for future sustainability and to negate inflation. The current provisions of 85% application for charitable purposes should be retained.*

3. **CONCERN:** Business Activity of An NPO- Presently the incidental business activity is allowed under the Income Tax Act for the specified category of NPOs. The proposed Code has restricted the coverage of incidental business activity and has allowed only those business activities which are carried on while actually undertaking the welfare activities. This is a proposal in the right direction. However, after this change there is no need to deprive the sixth category NPOs from engaging in business activities. The current law and the proposed code prohibit business activities in case of NPOs engaged in '*Advancement of any other activity of general public utility*'.

IMPACT: Now since the new code has redefined the incidentality of business and no NPO can engage in unrelated business activities, there is no need to prohibit one category of NPOs from engaging in business activity. In any case all categories of NPOs have to engage in incidental business activities only. If the business activity is incidental, then there is no reason why the benefit would not be extended to all categories of NPOs. The Direct Tax Code has already taken an understandable step by providing under section 96 that '*business shall be treated as incidental only if it is carried on in the course of implementing welfare activities*'.

RECOMMENDATION: *Clause (b) to section 96 of the proposed DTC should be deleted, since no NPO is allowed to have business which is not incidental. Therefore, all NPOs should be allowed to undertake business activities if carried on in the course of implementing charitable activities.*

4. **CONCERN:** Conversion of an NPO into commercial organisation - Under section 94 it is provided that if the NPO converts itself into an organisation which does not qualify for exemption, then it shall be liable to be taxed at the rate of 30% of its net worth.

IMPACT: Such provision may cause problem to NPOs which are not considered as "charitable" in some assessment year for insignificant reasons. Further, this provision seems to be very harsh as it proposes to tax the entire net worth accumulated over the years.

RECOMMENDATION: *Section 94 of the proposed DTC should be deleted as the other provisions of DTC have already addressed the issue. In other words, if an NPO ceases to be charitable, then automatically it will be taxed as an Association of Persons (AOP). There is no need for Section 94, since under the Income Tax Act, there is no provision for a public charity to convert itself into a commercial organisation. Its assets in any case have to be given to another valid charitable organisation even in case of dissolution. An NPO can not register under the Income Tax Act if its objects permit conversion into a commercial entity.*

Sir, we would like to appeal to you and your Ministry to reconsider these issues. We do appreciate your concern of rationalising the tax regime, but there is need to also consider the adverse effects it will have on the NPOs who are involved in socio-economic development of poor of this country once this code is applied. It will not only hinder the functioning of these organisations but also put their future sustainability under threat.

We are hopeful that you will be kind enough to reconsider our appeal before finalizing the Direct Taxes Code.

Yours sincerely,

Signature

Address of the organization.