

# Standards & NORMS

An initiative of FMSF

Legal Series Vol. II, Issue 2, July 2009

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## BUDGET 2009 - CHARITABLE PURPOSE

(To be read with Standards and Norms, Vol. I, Issue 6, January 2009)

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### INTRODUCTION

The Finance Act 2008 and the Finance Bill 2009 have introduced radical changes in the definition of a charitable organisation. Under the amended law, certain selected category of NGOs have been allowed to indulge in business and commercial activities even if it is not incidental to their objectives. On the other hand, all other NGOs have been deprived from engaging in even incidental business activities. The argument of the government is that the amendment is made to stop the misuse of income tax exemptions by commercial entities, but ironically NGOs such as educational and medical institutions who have been judicially found to be engaged in commercial activities (*Vodithala Education Society v. ADIT (Exemptions) II, Hyderabad : [2008] 20 SOT 353 HYD.*) have

been specifically allowed to carry on business activities. It remains inscrutable why the non-incidental commercial activity of NGOs should not be prohibited for all categories. And why all valid NGOs should not be allowed to do incidental business activities.

### CHANGES MADE IN DEFINITION OF 'CHARITABLE PURPOSES'

The Finance Bill 2009 has proposed amendment to the definition of 'charitable purpose' under section 2(15) of the Income Tax Act and consequently certain specific group of NGOs will not be allowed to have any business activity whether incidental or otherwise, the amended section 2(15) is as under :

“charitable purpose” includes relief of the poor, education, medical relief, *preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest*, 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;

The words in italics above has been inserted by the Finance Bill 2009. In effect the above amendment has excluded the residual category of NGOs from carrying on any kind of trade or business related activities.

### **THREE NEW LIMBS OF 'CHARITABLE PURPOSE' DEFINED**

The effect of this amendment will divide charitable purpose into the following 7 limbs :

- relief of the poor,
- education,
- medical relief,
- *preservation of environment (including watersheds, forests and wildlife)*
- *preservation of monuments or places or objects of artistic interest*,
- *preservation of monuments or places or objects of historic interest*
- and the advancement of any other object of general public utility

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Out of the 7 categories of NGOs only the last category i.e. ‘advancement of any other object of general public utility’ is not entitled to carry on any business or commercial activity even if it is incidental to its charitable purpose. The other 6 categories can engage in business or commercial activities even if it is not entirely incidental but the profits are used for charitable purposes. The government seems to have realised that some NGOs falling in the fourth category, earlier, deserved to be allowed to engage in business activities. Therefore, three new limbs have been created out of the erstwhile fourth category ‘advancement of any other object of general public utility’. The point is that there might be many such categories of NGOs which deserve to be treated on par with the first 6 categories but are languishing in the residual 7th category, for example; a Gandhian NGO trading in Khadi products or an NGO working on Woman Rights and gender issues. Therefore, it is imperative that the amendment is made in proper perspective. Currently the first 6 categories can engage in any kind of business activities whether incidental or not (going by the Supreme Court ruling in *Asstt CIT Vs Thanti trust (2001)247 ITR 785(SC)*). On the other hand the 7th category NGO cannot do even incidental business activities. The amendments seem to be a step with right intentions in a wrong direction. The right way should have been to prohibit all categories of NGO from engaging into business or commercial activities which is

not incidental to its objects and allowing all NGOs to carry on business activities provided it is integral and incidental to its charitable purpose. In our country there are many medical and educational institutions which run like commercial entities but enjoy income tax exemptions as charities. Rather an undefined and open category of NGOs have been affected by this amendment.

### **CONSTITUTIONAL VALIDITY**

The constitutional validity of the amendment section 2(15) and the explanatory circular thereof seriously comes into reckoning, even though the judicial precedence generally is in favour of revenue and provides considerable leeway of discrimination with regard to economic and tax laws. *In Shri Ram Krishna Dalmia vs. Justice S.R. Tendolkar AIR 1958 SC 538*, the Supreme Court laid down the principles with regard to judging the Constitutional validity of various statutes. It stated that generally there is a presumption in favour of the constitutionality of enactment and the burden is upon someone who challenges it to prove that there is a clear violation. However, it further laid down that in case of discrimination in favour or against any class, the presumption of constitutionality cannot be carried to the extent of holding that there must be some undisclosed and unknown reasons for subjecting individuals or corporations to hostile or discriminating legislation.

If we study the impact of the amendment it is clear that the seventh category NGOs can not have even incidental business activity, which is contrary to the statutory intent of depriving entities engaged in commercial activities. This position taken seems to be in violation of article 14 of the Constitution which does not permit generalised discrimination. Since the seventh category of NGOs is the residual

*There seems to be  
a lack of political will  
in bringing  
commercially run  
medical and educational  
institutions to the tax net*

category and all NGOs other than the first six category shall fall in it, it cannot be considered as a specific class to be discriminated. Moreover, the intent of the amendment is to stop commercial entities from claiming tax exemptions but the result is that all the genuine NGOs are also denied incidental business activities which are permissible for the first six category of NGOs. These amendments in effect are targeting an undefined residual class for definite reasons. The entire seventh category has been targeted under the premise that there might be some commercial and masked entities. The reasons for presuming that commercial entities are there only in the seventh category have also not been provided.

In the case *Arun Kumar vs. Union of India (2006) 286 ITR 89 (SC)* the Supreme Court reiterated that a liberal interpretation should always be made in favour of the statute in order to avoid constitutional invalidity. However, it also made it clear that discrimination under article 14 of the Constitution should be under a classification based on intelligible differentia which is otherwise legal, valid and permissible. In the instant case of the business income of NGOs, there seems to be no apparent basis of classifying the open ended residual seventh category as a definite class for discrimination. For example, this amendment will affect huge organisations like Board for Control of

Cricket in India (BCCI) and at the same time it may also impact a small Gandhian NGO which works on the principle of Swaraj and manufactures and sells indigenous product. Considering both of them as one category and at the same time making the first six categories of NGOs (including medical and educational institutions) the privileged class does not seem to be constitutionally sustainable and legally intelligible.

### WAY FORWARD

The crux of the problem lies in the above mentioned Supreme Court ruling in *Thanti Trust Case (2001)* where the Supreme Court held that even unrelated business should be considered as incidental to charitable

purpose provided the entire income is used for charitable purposes. This ruling provided an undue advantage and an avenue to NGOs to engage in masked commercialisation under the definition of charitable work. There is an urgent need to make appropriate amendment to plug the misuse of the above Supreme Court ruling because even after the proposed amendment, such commercialisation might continue. Therefore, in the interest of our country and its constitutional sanctity it is necessary that appropriate measures are taken by understanding the problem in proper perspective. This anomaly could be resolved by making a simple amendment in Section 11(4A) which allows incidental business activities. This Section should be amended to provide that business should not be treated as incidental only if its revenue are used for charitable purposes.

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

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**FINANCIAL MANAGEMENT SERVICE FOUNDATION**  
Accountability House, A-5, Sector 26, Noida - 201 301,  
website : [fmsfindia.org](http://fmsfindia.org), e-mail : [fmsf@fmsfindia.org](mailto:fmsf@fmsfindia.org)

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