

Standards & NORMS

A Joint initiative of FMSF, VANI and IndianNGOs.com

Legal Series Vol. I, Issue 7, February 2009

For private circulation only

INTER-CHARITY DONATIONS

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OVERVIEW OF INTER-CHARITY DONATIONS

1.1 Donation to another charity with similar objects is considered as an application of income for charitable or religious purposes.

1.2 It is not necessary for the donee to utilise the funds in the year of receipt. CBDT Instruction No.1132 (1978), has clarified that if the donee organisation does not utilise in the year of receipt, then the exemption to donor will not be affected.

1.3 The Assessing Officer should be satisfied that the donation is a *bona fide* initiative and would be used by the donee for charitable purposes only. In other words, unqualified benefit to the donor is not available.

1.4 High Courts have held that even inter-charity donations towards corpus is a valid application. But this contention is debatable and may require re-consideration.

1.5 After 1-4-2002, inter-charity donation out of accumulated funds is not possible except in the case of dissolution of the donor organisation.

1.6 Organisations receiving funds towards the end of the year can still make inter-charity donations by applying the option under *Explanation* to section 11.

1.7 Under FCRA inter-charity donation is possible only if the subsequent receiver is also having FCRA registration.

1.8 Donation to NGOs outside India is generally not permissible except in certain specified circumstances. Donation to foreign NGOs out of FCRA funds is not permissible

DONATION TO ANOTHER CHARITABLE ORGANISATION IS APPLICATION

2.1 It has been held in various cases that donation made by one charitable organisation to another shall be considered as an application for the purposes of section 11(1)(a) of the Income Tax Act. The donee must also be a public charitable organisation. In *CIT v. J. K. Charitable Trust* [1992] 196 ITR 31 (All.), it was held that contribution to other charitable trust was within the power and competence of the trustees. In this case, the deed of trust, *inter alia*, empowered the trustees to apply the income of the trust for “the advancement of any other object of general public utility as the trustees may in their absolute discretion deem fit and in such a way as they may consider most advantageous to the recipients.”

2.2 A charitable purpose may be served in more than one way. One is to directly contribute for the promotion of that cause; the other is to contribute money to another charitable organisation, which advances that cause.

THE CBDT CIRCULAR

3.1 The CBDT had also issued an instruction in this regard which provides that payment of sum by one charitable trust to another for utilisation by the donee trust towards its charitable objects is proper application for charitable purposes. The CBDT Instruction No. 1132, dated 5-1-1978 is reproduced as under :

“A question has been raised regarding the availability of exemption in the hands of Charitable Trusts of amounts paid as donations to other Charitable Trusts.

The issue has been considered by the Board and it has been decided that as the

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law stands at present the payment of a sum by one Charitable Trust to another for utilisation by the donee trust towards its charitable objects is proper application of income for charitable purposes on the hands of the donor trust, and the donor trust will not lose exemption under section 11 of the donations during the year of receipt itself.”

3.2 It may be noted that the above instruction also provides that the donor trust will not lose exemption if the donee trust does not spend the donation during the year of receipt itself.

SUPREME COURT’S VIEW

4.1 The Supreme Court in *CIT v. Thanthi Trust* [1999] 239 ITR 502, has also upheld the treatment of inter-charity donations as valid application of funds. In this case Supreme Court further held that the Assessing Officer cannot deny exemptions to the donor if the donee had not expended the amounts received in the year of receipt. The following extract from the Supreme Court decision further clarifies the issue :

“ . . . If the amounts had been actually handed over to the Adityanar College during the assessment years in question, the assessee could claim the benefit of exemption under section 11, as the college has been established only for the

educational purposes and no part of its fund can be utilised for non-charitable purposes, and the Revenue cannot insist that unless the educational institution expends the amount donated by the assessee within the assessment year, the assessee cannot claim the benefit of exemption under section 11.” (p. 504)

4.2 Similar views were also taken in *CIT v. Aurobindo Memorial Fund Society* [2001] 247 ITR 93 (Mad.) and *CIT v. Matriseva Trust* [2003] 128 Taxman 261 (Mad.). To sum up, inter-charity donations have been held as application for the purposes of section 11(1)(a) provided the donee is also a public charitable organisation. Once the funds have been donated, the donee will be subject to the income-tax provisions and the donor cannot be denied exemption if the money is not spent in the year of receipt.

DONEE SHOULD UTILISE FUNDS FOR CHARITABLE PURPOSES ONLY

5.1 As discussed, the funds donated to other charitable organisations are to be applied for charitable purposes only and if the donee organisation does not spend the donation for charitable purposes, then it may not be treated as an application, though it is not necessary that the donation should have been utilized in the year of receipts itself. In this regard, there is a modified CBDT Instruction No. 1582, dated 19-10-1984, which states that the Assessing Officer should satisfy himself that the funds donated to the donee trust would be utilized only for charitable purposes. The text of the circular is provided in *Annexure 1*.

5.2 This circular was issued prior to the Supreme Court ruling in the *Thanthi Trust's* case but the contents of this instruction are very clarificatory in nature which clearly provides that an unqualified benefit to the

It was held that corpus donation to another NGO was also within the ambit of valid application.

donor is not possible. Such donations are subject to the satisfaction of the Assessing Officer regarding their charitable nature and utilisation.

INTER-CHARITY DONATIONS TOWARDS CORPUS

6.1 In *CIT v. Sarladevi Sarabhai Trust* [1988] 172 ITR 698 (Guj.), it was debated whether donation by one charitable trust to another such trust, towards its corpus can be treated as application for charitable purposes. It was held that corpus donations were also within the ambit of valid application. It was further held that it was immaterial that both the trusts were created by the same group of persons. This ruling looks debatable and controversial, because it allows indefinite retention of funds through another charity.

6.2 It is evident from the above case that corpus donations are also permissible. In other words, a charitable organisation can make inter-charity donation towards corpus and also claim exemption even if the donee organisation does not apply those funds for charitable or religious purposes. The Court has held that since formation of a corpus is also for charitable or religious purposes as the income arising out of it can be used for charitable or religious purposes, therefore, the donor trust should not be disentitled of exemptions.

6.3 In *CIT v. Shri Ram Memorial Foundation* [2004] 269 ITR 35 (Delhi), the court relied upon the Division Bench decision of Gujarat High Court in *CIT v. Sarladevi Sarabhai (supra)*, it was observed that whether the donee trust utilises the amount or keeps it intact as corpus would not make the slightest differences as far entitlement of donor trust for exemption is concerned.

6.4 It is respectfully submitted that allowing corpus donations as valid application for charitable purposes tantamounts to indefinite accumulation of funds through another organisation. Therefore it defeats the very purpose of having the clause of 85% utilisation of income during the year itself. In other words an NGO may not receive corpus donation but can give corpus donation from such non corpus income.

6.5 For example, if the total income of an organisation is Rs. 1,00,000 then it cannot create a corpus of Rs. 1,00,000 for itself as it has to apply 85 per cent of it for charitable purposes. But if you go by the above rulings then the organisation can make a corpus donation of Rs. 1,00,000 to another organisation and such other organisation can retain this sum forever without applying it for charitable purposes. If corpus donation is allowed as application of funds, you are allowing an organisation to do something through another organisation, which it cannot do it by itself.

6.6 It is also pertinent to mention here that the Finance Act, 2002 has disallowed inter-charity donations out of accumulated funds. The legal purpose of this amendment was to plug the practices of rotating funds within sister concerns with the help of the provision of section 11(2) under which one organisation accumulates funds for five years and in the fifth year it donates it to another organisation which again accumulates it for five years and the chain continues. Such practices are not possible now. But allowing corpus donation is another loophole which still exists.

Funds once accumulated under section 11(2) can only be applied for charitable purposes directly by the concerned organisation and any inter-organisation transfer would not be possible.

6.7 Corpus of Harvard University - Though not in a strict legal context but it is pertinent to mention that purpose and use of corpus fund is a subject matter of debate throughout the world. The corpus fund of Harvard University is reportedly around 20 billion dollars, which is close to 1,00,000 crore of rupees. In USA, the debate has already started about the rationale and necessity of creating large corpus funds. In the long run, do they really justify the vision and mission of the organisation? Around 900 billion dollars are lying in various corpus funds of American Charities and Foundations. However, in India we do not come across such staggering instances.

DONATIONS TO OTHER CHARITABLE INSTITUTIONS AFTER 1-4-2002

7.1 The Finance Act, 2002 inserted an *Explanation* to sub-section (2) of section 11. This *Explanation* prohibits donations to other charitable organisations out of the accumulated funds. This amendment provision has created practical problems to many NGOs particularly the mother NGOs and Networks who receive donation on behalf of another group of NGOs. The new amendment puts restriction on donations to other charities out of accumulated funds. In other words, funds once accumulated under section 11(2) can

only be applied for charitable purposes directly by the concerned organisation and any inter-organisation transfer would not be possible.

7.2 However, inter-organisation donations are possible from current year's income, but the amended provision has created hurdles for organisations, which act as conduit for channelising funds to other organisations.

7.3 The *Explanation* inserted by the Finance Act, 2002, to section 11(2) has debarred organisations from applying its accumulated or set-apart income by way of payment or credit to other such organisations. Now, payments or credits out of accumulated funds to any other organisation would not be treated as application for charitable or religious purpose, though such transfer may still be possible out of the current year's income under section 11. CBDT has also issued a clarificatory circular No. 8, dated 27-8-2002.

INTER-CHARITY DONATION IN CASE OF DISSOLUTION

8.1 The Finance Act, 2003 has inserted another proviso to sub-section (3A) of section 11 which provides that inter-charity donation out of accumulated funds will be permissible in case of dissolution of a charitable organisation.

8.2 This amendment has been made to reduce the hardship of charitable organisation on the brink of dissolution. The amended proviso is as under :

“Provided further that in case the trust or institution, which has invested or deposited its income in accordance with the provisions of clause (b) of sub-section (2), is dissolved, the Assessing Officer

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may allow application of such income for the purposes referred to in clause (d) of sub-section (3) in the year in which such trust or institution was dissolved.”

8.3 Therefore, in the year of dissolution the NGO can make inter-charity donation from the current year income as well as accumulated funds.

TAX PLANNING FOR MOTHER NGOS AND NETWORKS

9.1 The prevailing and amended provisions with regard to inter-charity donations pose hardship to those organisations which act as a mother NGO to many small charitable organisations and funds through various foreign and domestic sources are routed through them. Many donors prefer to fund through one mother NGO which subsequently distributes the funds to smaller NGOs. After the amendment made in 2002 it has become difficult to disburse funds received towards the end of the year. And since accumulated income is not available for inter-charity donations, the funds could neither be applied nor could be donated to other charities.

9.2 *The likely problem* : For instance if a charitable organisation receives funds in the month of March — which is required to be

distributed to other charitable organisations — and is unable to make inter-charity donations within the year of receipt, then it has to accumulate the same. Once the income is accumulated under section 11(2) then it is not permissible to make inter-charity donations.

9.3 The solution to the problem : Under the above-mentioned circumstances a charitable organisation may exercise the option available under Explanation to section 11.

9.4 The Explanation to section 11 refers to two situations where the income applied falls short of 85 per cent and still can be deemed to have been applied in the previous year. The two situations are

- (i) when the income is not received but accrued
- (ii) for any other reason.

9.5 Under the second situation where the assessee may have received the fund towards the end of the year, then the assessee may exercise its option by applying in writing before the expiry of the time allowed under section 139(1) for filing of return. After exercise of the option the income will be deemed to have been applied in the previous year even though it is spent in the succeeding or the year of receipt.

9.6 Inter-charity donations being valid application of income, there is no reason why option under *Explanation 2* to section 11(1) could not be applied and the income be actually spent/dispensed in the succeeding year. But the reasons have to be genuine, the organisation must have valid reasons for not being able to apply the income as inter-charity donations in the year of receipt.

SECOND AND SUBSEQUENT RECIPIENT

10.1 Under section 2(1)(c) of FCRA, “foreign contribution” means the donation,

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delivery or transfer made by any foreign source of any currency whether Indian or Foreign.

10.2 The above definition of foreign funds was enlarged by FCR (Amendment) Act, 1985 wherein an *Explanation* was inserted which is as follows :

“Explanation : A donation, delivery or transfer of any article, currency or foreign security referred to in this clause by any person who has received it from any foreign source, either directly or through one or more persons, shall also be deemed to be foreign contribution within the meaning of this clause;”

10.3 The effect of this *Explanation* has brought the subsequent receipt of foreign funds within the scope of foreign contribution. Therefore if an organisation receives funds which are foreign funds received by another organisation, they still will be considered as foreign funds even if they are received locally in Indian currency.

10.4 Thus, organisations have been debarred from making contribution to organisation not registered under FCRA. It is mandatory for the second or subsequent recipients to possess FCRA registration or prior permission. Therefore, inter-charity donation to non FC organisation is possible out of current year’s income from domestic sources only.

DONATIONS TO NGOs IN OTHER COUNTRIES

11.1 Making inter-charity donations to NGOs outside India is extremely difficult though not impossible under the current legal environment. An overview of the provisions in this regard is as follows :

11.2 Under the provisions of Income Tax Act, 1961, income applied on activities outside India is not eligible for exemption unless the following conditions are satisfied : (a) The charitable organisation happens to be a trust created before 01-04-1952 or it is engaged in promotion of international welfare in which India is interested. (b) Central Board of Direct Taxes (CBDT) has by general or special order granted the exemption.

11.3 NGOs registered under section 10(23C) may have some activities outside India but to claim exemptions they should primarily be working in India only. Therefore, one needs to distinguish between an NGO registered under section 12A and section 10(23C).

11.4 It may be noted that if an organisation incurs expenditure outside India in contravention of section 11(1)(c), then the entire exemption will not be lost. Income to the extent not applied in India will not be eligible for exemption.

11.5 Under the current income tax provisions it seems that NGOs registered under section 12A cannot transfer funds to any foreign NGO or have any activity outside

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India out of the current year's income. However, it seems that it can have some activities out of its accumulated free reserves.

11.6 If there is a clause in the trust deed which provides for activities outside India, it would not disentitle the organisation from claiming exemption. The provisions of section 11(1)(c) are attracted only if actual expenditure is incurred outside India.

11.7 FCRA funds under no circumstances can be transferred out of India, therefore, activities outside India (if any) has to be done from domestic income only. Because FCRA requires the subsequent receiver to have FC registration which will not be possible for a foreign NGO. The FCRA Act has not envisaged the possibility of Indian NGOs working outside India from foreign contributions received.

CBDT INSTRUCTION NO. 1582, DATED 19-10-1984

“The Board have by Instruction No. 1132, dated 5-1-1981 [F. No.176/89/77-IT (AI)] stated that the donation by one charitable trust to another for utilisation by the donee trust towards its charitable objects is application of income for charitable purposes in the hands of the donor trust, and the donor will not lose exemption under section 11 of the I.T. Act, 1961 merely because the donee trust did not apply the donations towards the charitable purposes during the year of receipt itself.

The Receipt Audit have expressed doubts about the validity of these instructions and they were of the view that this could be a means to avoid the restrictions placed on accumulation of income of charitable and religious trusts as they could be applied by transferring the income to other institutions. They have pointed out that the donation of income of one charitable or religious institution to another, especially when such income is not utilised by the donee institution in the year of receipt, would not constitute application of income for charitable and religious purposes. Keeping in view the audit objection and the judgments of Bombay High Court in *CIT v. Trustees of the Jadi Trust* [1982] 133 ITR 494 and Madras High Court judgment in *CIT v. Thanthi Trust* [1982] 137 ITR 735, Board referred the matter to Ministry of Law for their opinion. Ministry of Law opined that these decisions are not valid for giving unqualified benefit to the donor trust under section 11 where the application of income for charitable purposes is made through the medium of the donee trust. Before giving the benefit under section 11 if the facts and circumstances of the case require, the ITO has to be satisfied that the funds which have been donated to the donee trust will be utilised only for charitable purposes.

Board’s Instruction No. 1132 referred to above stands modified to this extent.”

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

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Published by **Mr. Sanjay Patra** on behalf of
FINANCIAL MANAGEMENT SERVICE FOUNDATION
Accountability House, A-5, Sector 26, Noida - 201 301,
website : fmsfindia.org, e-mail : fmsf@fmsfindia.org

and

Voluntary Action Network India (VANI)
www.vaniindia.org

and

www.IndianNGOs.com