U.S. INTERNATIONAL GRANTMAKING

Country Information

India

Current as of June 2008

Explanatory Note: The following Country Note principally focuses on national all-India legislation governing not-for-profit organizations in India. Readers should be aware that state laws and regulations, often adapted from the national laws, are also important to this framework. Moreover, the Charity Commissions and Registrars are state entities, not national ones. Thus, regulation of not-for-profit organizations varies from state to state. Detailed discussion of the state laws is beyond the scope of this Note.

Table of Contents

I. Summary

A. Types of Organizations

1. Trusts

Public charitable trusts can be established for a number of purposes, including the relief of poverty, education, medical relief, provision of facilities for recreation, and any other object of general public utility. Indian public trusts are generally irrevocable. No national law (except the broad principles of the India Trusts Act, 1882, which governs private trusts) governs public charitable trusts in India, although many states (particularly Maharashtra, Gujarat, Rajasthan, and Madhya Pradesh) have Public Trusts Acts.

2. Societies

Societies are membership organizations that may be registered for charitable purposes. Societies are usually managed by a governing council or a managing committee. Societies are governed by the Societies Registration Act, 1860, which has been adapted by various states. Unlike trusts, societies may be dissolved.

3. Section 25 Companies

A section 25 company is a company with limited liability that may be formed for "promoting commerce, art, science, religion, charity or any other useful object," provided that no profits, if any, or other income derived through promoting the company's objects may be distributed in any form to its members.

B. Tax Laws

India’s tax laws affecting not-for-profit organizations (NPOs) are similar to the tax laws of other Commonwealth nations

India provides for exemption from corporate income taxes the income of certain NPOs carrying out specific types of activities, with unrelated business income being subject to tax under certain circumstances.

India also subjects certain sales of goods and services to VAT, with a fairly broad range of exempt activities. The rates range from 1 percent to 12.5 percent, with most goods and services taxed at 12.5 percent. VAT liability arises only if the total turnover of sales is Rs.500,000 (Rs.100,000 if the dealer is an importer).

The income tax law and the corporate tax law provide tax benefits for donors. India and the United States have signed a double taxation treaty.

Finally, NPOs involved in relief work and in the distribution of relief supplies to the needy are 100% exempt from Indian customs duty on the import of items such as food, medicine, clothing and blankets. Other exemptions may also be available.

II. Applicable Laws

- Constitution of India, Articles 19(1)(c) and 30;
- Income Tax Act, 1961;
- Public Trusts Acts of various states;
- Societies Registration Act, 1860;
- Indian Companies Act, 1956, section 25;
- Foreign Contribution (Regulation) Act, 1976;
- Maharashtra Value Added Tax Act, 2002, as amended by Act No. IX of 2005.

Other legal authorities consulted in preparing this Note:

Noshir H. Dadrawala's "IRNL Country Report on the Framework Governing Not-for-Profit Organizations in India"

Noshir H. Dadrawala's "Report on Indian Finance Bill 2006"

III. Relevant Legal Forms

A. General Legal Forms

The right of all citizens to form associations or unions is guaranteed by the Constitution of India, Article 19(1)(c).

There are three pertinent legal forms of not-for-profit entities under Indian law: trusts, societies, and section 25 companies (cooperatives and trade unions are mutual benefit organizations, and as such, are not discussed in this Note). Many state and central government agencies have regulatory authority over these not-for-profit entities. For example, all not-for-profit organizations are required to file annual tax returns and audited account statements with various agencies. At the state level, these agencies include the Charity Commissioner (for trusts), the Registrar of Societies (referred to in some states by different titles, including the Registrar of Joint Stock Companies), and the Registrar of Companies (for section 25 companies). At the national or federal level, the regulatory bodies include the income tax department and Ministry of Home Affairs (only for not-for-profit organizations receiving foreign contributions).

1. Trusts

Public charitable trusts, as distinguished from private trusts, are designed to benefit members of an uncertain and fluctuating class. In determining whether a trust is public or private, the key question is whether the class to be benefited constitutes a substantial segment of the public. There is no central law governing public charitable trusts, although most states have "Public Trusts Acts." Typically, a public charitable trust must register with the office of the Charity Commissioner having jurisdiction over the trust (generally the Charity Commissioner of the state in which the trustees register the trust) in order to be eligible to apply for tax-exemption. In general, trusts may register for one or more of the following purposes:

- Relief of poverty or distress;
- Education;
- Medical relief;
- Provision of facilities for recreation or other leisure-time occupation (including assistance for such provision), if the facilities are provided in the interest of social welfare and public benefit; and
- The advancement of any other object of general public utility, excluding purposes which relate exclusively to religious teaching or worship.

At least two trustees are required to register a public charitable trust. In general, Indian citizens serve as trustees, although there is no specific prohibition against non-natural legal persons or foreigners serving in this capacity.

Legal title of the property of a public charitable trust vests in the trustees. Trustees of a public charitable trust may not, however, in any way use trust property or their position for their own interest or private advantage. Trustees may not enter into agreements in which they may have a personal interest that conflicts or may possibly conflict with the interests of the beneficiaries of the trust (whose interests the trustees are bound to protect). Trustees may not delegate any of their duties, functions or powers to a co-trustee or any other person, except that trustees may delegate ministerial acts. In essence, trustees may not delegate authority with respect to duties requiring the exercise of discretion.

Trustees of religious or charitable trusts are charged with discharging their duties with the degree of care that an ordinarily prudent person would exercise with respect to his personal property. Public charitable trusts are highly regulated. For instance, in many states, purchases or sales of immovable property by a trust or taking a loan must be approved in advance by the Charity Commissioner.

Indian public charitable trusts are generally irrevocable. If a trust becomes inactive due to the negligence of its trustees, the Charity Commissioner may take steps to revive the trust. Furthermore, if it becomes too difficult to carry out the objects of a trust, the doctrine of *cy pres*, meaning "as near as possible," may be applied to change the objects of the trust.

2. Societies

Societies are governed by the Societies Registration Act 1860, which is an all-India Act. Many states, however, have variants on the Act.

Societies are similar in character to trusts, although there are a few essential differences. While only two individuals are required to form a trust, a minimum of seven individuals are required to form a society. The applicants must register the society with the state Registrar of Societies having jurisdiction in order to be eligible to apply for tax-exempt status. A registration application includes the society's memorandum of association and rules and regulations. In general, Indian citizens serve as members of the managing committee or governing council of societies, although there is no prohibition in the Societies Registration Act against non-natural legal persons or foreigners serving in this capacity.

According to section 20 of the Act, the types of societies that may be registered under the Act include, but are not limited to, the following:

- Charitable societies;
- Societies established for the promotion of science, literature, education, or fine arts; and
- Public art museums and galleries, and certain other types of museums.

The governance of societies also differs from that of trusts; societies are usually managed by a governing council or managing committee, whereas trusts are governed by their trustees.

Individuals or institutions or both may be members of a society. The general body of members delegates the management of day-to-day affairs to the managing committee, which is usually elected by the membership. Members of the general body of the society have voting rights and can demand the submission of accounts and the annual report of the society for inspection. Members of the managing committee may hold office for such period of time as may be specified under the bylaws of the society.

Societies, unlike trusts, must annually file a list of the names, addresses and occupations of their managing committee members with the Registrar of Societies. Furthermore, in a society all property is held in the name of the society, whereas all of the property of a trust legally vests in the trustees.

Unlike trusts, societies may be dissolved. Dissolution must be approved by at least three-fifths of the society's members. Upon dissolution, and after settlement of all debts and liabilities, the funds and property of the society may not be distributed among the members of the society. Rather, the remaining funds and property must be given or transferred to some other society, preferably one with similar objects as the dissolved entity.

3. Companies

The Indian Companies Act, 1956, which principally governs for-profit entities, permits certain companies to obtain not-for-profit status as "section 25 companies." A section 25 company may be formed for "promoting commerce, art, science, religion, charity or any other useful object." A section 25 company must apply its profits, if any, or other income to the promotion of its objects, and should not pay any dividend to its members. At least three individuals are required to form a section 25 company. The founders or promoters of a section 25 company must submit application materials to the Regional Director of the Company Law Board. The application must include copies of the memorandum and articles of association of the proposed company, as well as a number of other documents, including a statement of assets and a brief description of the work proposed to be done upon registration.

The internal governance of a section 25 company is similar to that of a society. It generally has members and is governed by directors or a managing committee or a governing council elected by its members.

Like a society (but unlike a trust), a section 25 company may be dissolved. Upon dissolution and after settlement of all debts and liabilities, the funds and property of the company may not be distributed among the members of the company. Rather, the remaining funds and property must be given or transferred to some other section 25 company, preferably one having similar objects as the dissolved entity.

B. Public Benefit Status

To be eligible for tax-exemption under the Income Tax Act, 1961, a not-for-profit entity must be organized for religious or charitable purposes. Charitable purposes include "relief of the poor, education, medical relief, and the advancement of any other object of general public utility." Finance Act, 2008 has amended the definition of "charitable purpose." Specifically, if the "advancement of any other object of general public utility" involves undertaking any trade, commerce, or business activities or rendering any related service for a fee or any other condition (irrespective of use, application, or retention of income arising from such activities), it will not be considered a "charitable purpose." Organizations established for and running programs for relief of poverty, education, and medical relief are not affected by this amendment.

Public charitable trusts, by definition, must be created for the benefit of the public. Societies likewise may be registered for charitable purposes. Section 25 companies are formed for the limited purposes of "promoting commerce, art, science, religion, charity or any other useful object."

IV. Specific Questions Regarding Local Law

A. Inurement

Public charitable trusts must benefit a large class of beneficiaries and must be for the public benefit. Moreover, trustees of public charitable trusts may not engage in self-dealing.

The Societies Registration Act, 1860 does not prohibit the inurement of any earnings of the society to any private shareholder or individual.

The Indian Companies Act, 1956, section 25 specifically provides that no profits, if any, or other income may be distributed by way of dividends to its members.

The Income Tax Act, 1961 specifically provides that a not-for-profit entity will lose tax exempt status if the author, founder, or any trustee or his/her relative derives any personal benefit. The Income Tax Act further provides that any remuneration paid to a Board Member "must not be in excess of what may be reasonably paid for such services."

B. Proprietary Interest

Whether an individual may have a proprietary interest in a not-for-profit entity relates to the issue of inurement. Trustees of a public charitable trust hold trust assets on behalf of the trust. Thus, although trustees have legal title to the trust's assets, they hold these assets for the beneficiaries of the trust, not for themselves. Members of the managing committee or governing council of a society or section 25 company hold the assets of a society or section 25 company.

C. Dissolution

Indian public charitable trusts are generally irrevocable. If a trust becomes inactive due to the negligence of its trustees, the Charity Commissioner may take steps to revive the trust. Furthermore, if it becomes too difficult to carry out the trust's objectives, the doctrine of *cy pres*, meaning "as near as possible," may be applied to change the objectives of the trust. Under certain circumstances a trust can also be officially declared as inoperative, defunct or moribund.

Unlike trusts, societies and section 25 companies may be dissolved. Upon dissolution and after settlement of all debts and liabilities, the funds and property of the society or company may not be distributed among the members. Instead, the remaining funds and property must be given or transferred to some other society or section 25 company, preferably one with similar objectives.

D. Activities

Economic Activities

There are no restrictions on an Indian NPO's business/commercial/economic activities provided the NPO is established for and primarily runs programs for relief of poverty or distress, education, and medical relief. However, profits must be applied fully towards charitable objects. If this is not done, then the NPO will lose its income tax exemption and its income will be liable to tax at the maximum marginal rate (30%). Further the NPO must maintain separate books of account for the business/commercial/economic activities. [Income Tax Act, 1961 (seventh proviso to section 10(23C); section 11, subsection 4 and 4A)]

Investment Activities

State and national laws limit the types of investments Indian NPOs may make. For example, Indian NPOs may not invest in shares of public or private limited companies. Furthermore, not-for-profit organizations registered in India may not invest abroad. Finance Act, 2007 amended provisions of Section 13(1)(d)(iii) with retroactive effect to April 1, 1999, allowing NPOs to invest in shares of public sector companies as well as to acquire equity shares of a 'depository.'

E. Political Activities

Not-for-profit organizations in India may not engage in political campaign activities or legislative activities. Indian not-for-profit entities may "lobby" for non-political causes, however, provided that such activity promotes the "general public utility" and is incidental to the attainment of the charity's objects.

F. Discrimination

Article 30 of the Constitution of India gives all "minorities," whether based on religion or language, the right to establish and administer educational institutions of their choice. "Minority" is defined as those groups that wish to preserve stable ethnic, religious or linguistic traditions or characteristics markedly different from those of the rest of the population.

G. Control of Organization

With regard to charities in general, trustees are expected to be independent. It is, however, ordinarily possible for another legal person to influence the selection of directors, officers, or trustees – for example, by making a donation contingent on the donor's right to appoint a member of the board.

A for-profit company that creates a public charitable trust can exert more direct control. The for-profit company could, in the process of founding the public charitable trust, reserve the authority to appoint and remove trustees and to influence major policy decisions. This is typical of a form of public charitable trust known as a "corporate foundation," which is essentially controlled by its for-profit founder, or "settlor."

In the case of a section 25 company or a society, members always have the right to remove directors and thus to influence policy. These members can include for-profit entities.

Therefore, it is possible that an Indian charity may be controlled, perhaps indirectly, by a for-profit entity or by an American grantor charity (which requires that the charity specifically so provide in the affidavit).

V. Tax Laws

A. Tax Exemptions

1. General Scheme

The Income Tax Act, 1961, which is a national all-India Act, governs tax exemption of not-for-profit entities. Organizations may qualify for tax-exempt status if the following conditions are met:

- The organization must be organized for religious or charitable purposes;
- The organization must spend 85% of its income in any financial year (April 1st to March 31st) on the objects of the organization. The organization has until 12 months following the end of the financial year to comply with this requirement. Surplus income may be accumulated for specific projects for a period ranging from 1 to 5 years;
- The funds of the organization must be deposited as specified in section 11(5) of the Income Tax Act;
- No part of the income or property of the organization may be used or applied directly or indirectly for the benefit of the founder, trustee, relatives of the founder or trustee or a person who has contributed in excess of Rs. 50,000 to the organization in a financial year;
- The organization must timely file its annual income return;
- The organization's income must be applied or accumulated in India. However, trust income may be applied outside India to promote international causes in which India has an interest, without being subject to income tax; and
- The organization must keep a basic record (name, address and telephone number) of all donors. According to a new section 115BBC, introduced with the New Finance Act, 2006, all anonymous donations to charitable organizations will now be treated as taxable. Religious organizations (temples, churches, mosques) are exempt from the provisions of this new section.

2. Capital Contributions

Capital contributions or donations to an endowment should not be included when computing the total income of the organization.

3. Business Income

Under amendments to Section 11(4A) of the Income Tax Act, 1961, a not-for-profit organization is not taxed on income from a business that it operates that is incidental to the attainment of the objects of the not-for-profit organization, provided the entity maintains separate books and accounts with respect to the business. Furthermore, certain activities resulting in profit, such as renting out auditoriums, are not treated as income from a business.

4. Disqualification from Exemption

The following groups are ineligible for tax exemption: all private religious trusts; charitable trusts or organizations created after April 1, 1962; and charitable trusts established for the benefit of any particular religious community or caste. Note, however, that a trust or organization established for the benefit of "Scheduled Castes, backward classes, Scheduled Tribes or women and children" is an exception; such a trust or organization is not disqualified, and its income is exempt from taxation.[1]

B. Value Added Tax

India subjects certain sales of goods and services to VAT, with a fairly broad range of exempt activities. The rates range from 1 percent to 12.5 percent, with most goods and services taxed at 12.5 percent.

An entity (including a public charitable trust) is liable under the VAT Act if its sales/purchase turnover in the previous year exceeded Rs.500,000. The threshold is lower, Rs.100,000, for importers.

Several other tax laws have now merged into VAT, including the Sales Tax Act, Motor Spirit Taxation Act, Purchase Tax on Sugarcane Act, and the Transfer of Right to Use Act.

C. Tax Deduction for Donors

The Income Tax Act, section 80G, sets forth the types of donations that are tax-deductible. The Act permits donors to deduct contributions to trusts, societies, and section 25 companies. Many institutions listed under 80G are government-related; donors are entitled to a 100% deduction for donations to some of these government funds. Donors are generally entitled to a 50% deduction for donations to non-governmental charities. Total deductions taken may not exceed 10% of the donor's total gross income.

The following are examples of governmental charities listed in section 80G, contributions to which entitle the donor to a 100% deduction: the Prime Minister's National Relief Fund; the Prime Minister's Armenia Earthquake Relief Fund; the Africa (Public Contributions – India) Fund; and the National Foundation for Communal Harmony.

As to those entities not specifically enumerated in section 80G, donors may deduct 50% of their contributions to such organizations, provided the following conditions are met:

- The institution or fund was created for charitable purposes in India;
- The institution or fund is tax-exempt;
- The institution's governing documents do not permit the use of income or assets for any purpose other than a charitable purpose;
- The institution or fund is not expressed to be for the benefit of any particular religious community or caste; and
- The institution or fund maintains regular accounts of its receipts and expenditures.

Note that donations to institutions or funds "for the benefit of any particular religious community or caste" are not tax-deductible. A not-for-profit organization created exclusively for the benefit of a particular religious community or caste may, however, create a separate fund for the benefit of "Scheduled castes, backward classes, Scheduled Tribes or women and children." Donations to these funds may qualify for deduction under section 80G, even though the organization, as a whole, may be for the exclusive benefit of only a particular religious community or caste. The organization must maintain a separate account of the monies received and disbursed through such a fund.

In-kind donations are not tax-deductible under Section 80G. Receipts issued to donors by not-for-profit organizations must bear the number and date of the 80G certificate and indicate the period for which the certificate is valid.

The Income Tax Act contains a number of other provisions permitting donors to deduct contributions. Under section 35AC of the Act, donors may deduct 100% of contributions to various projects, including: 1) construction and maintenance of drinking water projects in rural areas and in urban slums; 2) construction of dwelling units for the economically disadvantaged; and 3) construction of school buildings, primarily for economically disadvantaged children. Furthermore, under section 35CCA of the Act, donors may deduct 100% of their contributions to associations and institutions carrying out rural development programs and, under Section 35CCB of the Act, 100% of their donations to associations and institutions carrying out programs of conservation of natural resources. A weighted deduction of 125% is also allowed for contributions to organizations approved under section 35(1)(ii) (a scientific research institute or a university, college, or other institution) specifically for "scientific research," and for contributions made under section 35(1)(iii) specifically for "research in social science or statistical research."

Finance Act, 2008 introduced a weighted deduction of 125% for contributions for scientific research, made to a company registered in India, whose main objective is scientific research and development, when those contributions are approved by the prescribed authority and fulfill specified conditions. Previously, such a deduction was available only for payments made to scientific research associations or to universities, colleges, or other institutions.

However, under Finance Act, 2008, the weighted deduction of 150% available under section 35(2AB) to qualifying companies and manufacturers for expenditures incurred on scientific research or in-house research and development, would not be available to a company approved under section 35(1)(iia).

D. Reporting Foreign Contributions

Under the Foreign Contribution (Regulation) Act, 1976 (FC(R)A), all not-for-profit organizations in India (e.g., public charitable trusts, societies and section 25 companies) wishing to accept foreign contributions must: a) register with the Central Government; b) agree to accept contributions through designated banks; and c) maintain separate books of accounts with regard to all receipts and disbursements of funds. Furthermore, not-for-profit entities must report to the Central Government all foreign contributions received within 30 days of the receipt of the contribution, and must file annual reports with the Home Ministry. The entity must report the amount of the foreign contribution, its source, the manner in which it was received, the purpose for which it was intended, and the manner in which it was used. Foreign contributions include currency, securities, and articles, except personal gifts under Rs.1,000. Funds collected by an Indian citizen in a foreign country on behalf of a not-for-profit entity registered in India are considered foreign contributions. Moreover, funds received in India, in Indian currency, if from a foreign source, are considered foreign contributions.

FC(R)A guidelines require that an organization allowed to receive funds from a foreign source may provide funds from its FC(R)A account to another organization, only if the other organization also has clearance from the Home Ministry to receive funds from a foreign source.

If the foreign donor agency specifies in writing that the whole or part of the grant may be directed to the recipient organization's capital fund or endowment, the organization may do so. Such an endowment or capital fund may be invested in an approved security.

The “interest” or “dividend” generated should be accounted for as an amount received by way of interest on a deposit drawn out of funds received from a foreign source.

In other words, even the interest/dividend received in India in Indian rupees must be disclosed in the Return Form FC-3.[2]

Contributions from expatriate Indians are not considered “foreign contributions” if an individual has become a citizen of a foreign country.

E. Customs Duty

Not-for-profit organizations involved in relief work and in the distribution of relief supplies to the needy are 100% exempt from customs duty on the import of items such as food, medicine, clothing, and blankets. Moreover, other exemptions may be available, such as an exemption from customs duty for scientific/technical equipment and components intended for research institutes. Donors should investigate whether an exemption from customs duty is available before shipping articles to not-for-profit entities in India.

F. Double Tax Treaty

India and the United States signed a double-tax treaty on September 12, 1989. The treaty does not address issues related to charitable giving or not-for-profit entities.

VI. Knowledgeable Contact

Noshir H. Dadrawala: centphil@bom7.vsnl.net.in

Footnotes

[1] These rules are subject to change, as a new Foreign Contribution (Management and Control) Bill is currently being considered to replace the Foreign Contribution (Regulation) Act, 1976 or FC(R)A. Additional information on the FC(R)A and related accounting issues can be found at http://www.accountaid.net/.

[2] Per a recent change, the last date for filing the annual return in Form FC-3 has been extended to December 31st. Previously, the filing deadline was July 31st.