

## **Recommendations of the Task Force on Direct Taxes for Charitable Trusts and NGOS**

Recommendations of The Task Force on Direct Taxes for Charitable Trusts and NGO's The Indian Income Tax Act, 1961 is one of the most complicated and confusing legislations from a common man's point of view. It has been amended hundred of times, resulting in a law which is almost incomprehensible to a layman.

To quote Nani Palkiwala "Today the Income Tax Act, 1961 is a national disgrace. There is no other instance in Indian jurisprudence of an Act mutilated by more than 3,300 amendments in less than 30 years. Simple provisions like section 11 and section 13 have suffered no less than 50 amendments."

To rationalise and simplify the Indian tax laws, The Ministry of Finance, Government of India constituted two Task Forces, one on direct taxes and the other on indirect taxes, under the chairmanship of Dr. Vijay Kelkar, former Finance Secretary and presently Advisor, Ministry of Finance & Company Affairs, Government of India.

The Terms of Reference of the Task Force included the following:

- Rationalisation and simplification of the direct taxes, with a view to minimising exemptions, removing anomalies and improving compliance procedure.
- Improvement in tax payer services so as to reduce compliance cost, impart transparency and facilitate voluntary compliance.
- Re-designing procedures for strengthening enforcement so as to improve compliance of direct tax laws.

### **DRAFT REPORT**

The task forces issued draft consultation papers in November 2002, which were open for public debates. Certain suggestions and recommendations were made for the charitable trusts and institutions in that draft paper, which are as follows:

#### **Provision regarding Registration of a Charitable Trust or Institution**

Charitable trusts and institutions require registration either under section 11 or 10(23C) of the Income Tax Act, 1961 for claiming exemption from income tax, subject to certain specified conditions. The compliance burden under the two schemes is different. The registration under section 11 is simpler compared to registration under section 10. For registration under section 10, the application is made to the Director General of Income Tax (Exemption) through the Commissioner of Income Tax having jurisdiction and is not just issued a registration certificate like under section 11. Contrarily, it is notified in the official gazette, which in a sense infers a certificate of national importance.

The Task Force received large number of grievances relating to delay in issue of

exemption notification by Central Board of Direct Taxes (CBDT) under section 10. Therefore, the Task Force recommended that the exemption under section 10 (21), 10(23B), 10(23C) (iiiab) to (vi a), and 10(29A) should be merged with Section 11 to 13A of the Income Tax Act. Consequently, there will be no requirement for any statutory notification to be issued by CBDT.

The Task Force also recommended that all charitable trusts and institutions will be required to file tax returns. Some will be selected for scrutiny. This will be done using a computerised risk assessment method. The Assessing Officer will examine the case. If he/ she feels that the charity may not be actually charitable, the case will be referred to a specialised rating agency from the panel drawn by Comptroller & Accounts General of India.

The rating agency will examine the case and will grade the charitable trust or institution. An "A+" rating for the trust will mean that it is indeed a charitable trust. An "A" rating for the trust will mean that it will enjoy exemption during the current year and will be subjected to review again in the following year. "B" rating for the trust will disqualify it from any tax exemption.

### **Deduction under Section 80G to the Donors**

At present, the donors get 50% deduction from the taxable income under section 80G for the donations to the NGO's registered under section 80G of the Income Tax Act, 1961. The maximum marginal rate of tax is 30%. This means that presently the maximum tax benefit to a donor may range from 5% to 15%. Secondly, there is a ceiling of 10% of gross income on total donations under section 80G. Donations to priority segments(armed forces, government relief funds etc.,) offer 100% deduction. Hence the effective rebate ranges from 10% to 30%.

Kelkar Committee suggests that everyone be offered the same tax rebate of 20%. The ceiling on donations should also be removed.

For instance, a taxpayer makes a donation of Rs.2000/- to a trust for which 50% deduction is allowed u/s 80G. In that case, the qualifying amount for deduction would be Rs.1,000/-(50% of Rs.2,000/-). Suppose, the income of taxpayer is more than Rs.1,50,000/- for which marginal rate of tax is 30%. Under the present arrangement, he will get a tax relief of 30% on the qualifying amount for deduction i.e.Rs.300/-. However, under the proposed scheme, he will get a rebate of 20% on the qualifying amount for deduction i.e.20% on Rs.1,000/- =Rs.200/- only.

### **Deduction under Section 80GGA, 35(1)(ii)(iii)**

The same treatment has been suggested for donations under section 80GGA and 35(1)(ii)(iii) also. This will result in some loss to bigger donors who may be paying tax at 30%.

### **REPRESENTATION TO DR. KELKAR**

A delegation comprising of NGO leaders and experts met Mr. Vijay Kelkar on 4th

December 2002 in his office at North Block, New Delhi to present the view of the NGO sector on the recommendations of the task force as well as to share the difficulties faced by the sector in practice. The members of the delegation were:

**Ms. Pushpa Sundar**, Executive Director, Sampradaan Indian Centre for Philanthropy, N.Delhi

**Mr. V. Rethinam**, FCA, New Delhi

**Mr. Sanjay Agrawal**, FCA, New Delhi

**Mr. Sanjay Patra**, Executive Director, Financial Management Service Foundation, New Delhi

**Mr. Anil Singh**, VANI, New Delhi

**Mr. Ajay Mehta**, Executive Director, National Foundation for India, New Delhi.

#### **Point of View of the Delegation on the recommendations of the Kelkar Committee :**

ã The recommendation that there should be no requirement of statutory notification to be issued by CBDT has been welcomed, since delays in getting exemption are a major problem.

ã A time limit should be prescribed for disposal of applications under section 35AC and 80G as it takes sometimes upto 2 years.

ã Regarding the grading system suggested by the Task Force, on one hand it could be a safeguard against excessive power with the Income Tax Officer since an independent rating agency may be more independent and objective. However, the following problems would arise in relation to this:

\* Firstly, which are these rating agencies? Do they exist or will they be formed now? How will they grade the charity and what method will they use?

\* Secondly, what is the appeal procedure against the grading done by one agency?

\* Thirdly, who will bear the cost of this exercise? Will the Government pay the rating agency? If so, the fees will be quite low, and, the rating agency may be tempted to accept favours from the concerned charity. On the other hand, if the charity is to pay the rating agency, then there may be some loss of objectivity, as also the question of having funds to pay the fees.

\* Another related question is the negative fallout of an adverse rating. At the moment, if one loses one's exemption because of violation of specific provision of the Income Tax Act, it does not necessarily mean that the organisation is not

charitable. This may also affect its image with the donors, public and the beneficiaries.

ã The recommendation to replace the existing tax benefits under section 80GGA and 35AC with a uniform tax rebate of 20% may reduce the charitable contributions in cases where the benefit under above sections is sought by affluent donors who may be paying tax @ 30%.

#### **New suggestions made to Dr. Kelkar by the Delegation on 4.12.2002:**

ã In the Finance Act, 2002, there was a reduction in the quantum of accumulation of income allowed from 25% of annual income to 15%. This is very restrictive and unnecessary, as charitable trusts sometimes require more funds and sometimes less. There should be flexibility in spending of funds or accumulating them.

ã Payment to other trusts out of accumulated funds was disallowed. The inter-charity donation out of accumulated funds should be allowed with the condition that the composite accumulation of both donor and donee should not exceed 5 years.

ã The provision for application in Form 13 to Assessing Officer for certificate in Form 15AA should be dispensed with the self declaration Form, as this is causing unnecessary paperwork and delay.

ã Exemption for donations in kind should be allowed for tax benefit.

ã Income for taxable purpose should be clearly defined, and all income from other sources should not be liable to tax.

ã Scope of section 80G needs to be enhanced by providing 100% tax exemption for all organisations.

ã Exemptions under section 35AC, 35(1)(iii) and 35 CCB should all be amalgamated and allowed 100% tax deductibility.

#### **Final Report**

During last week of December 2002, Kelkar Committee presented the final report. The final recommendations are as follows:

# The exemptions under Section 10(21), 10(23B) and 10(23C)(iiiab) to (vi a), 10(29A) should be merged with Section 11 to 13A of the Income Tax Act. However, the requirement to file a return of income by such trust and institutions as proof of fulfilling the various conditions stipulated u/s 10(23C), should continue.

# Returns to be identified for scrutiny / audit only through a computerised risk assessment system.

# Where a return is identified for scrutiny and the assessing officer is of the

opinion that the activities of the trust are not charitable in nature, such a case will be referred to a rating agency from amongst the panel drawn up by the C&AG. An "A+" rating for the trust will mean that it is indeed a charitable trust. An "A" rating for the trust will mean that it will enjoy exemption during the current year and will be subjected to review again in the following year. A "B" rating for the trust will disqualify it from any tax exemption.

# Since a large number of provisions in the Income Tax Act are regulatory in nature, it is recommended to create a National Charities Board to assist the government in regulating and promoting charities on the lines of the National Charities Commission, UK. Since, a number of States in India already have Charity Commissions, the proposed Board may have to be advisory.

# The Income Tax Department should reimburse to trusts, the fees payable to the rating agency.

# Consequent to the merger of all the provisions, there will be no requirement for any statutory notification to be issued by the CBDT. The Board will hereafter be able to devote more time on designing tax enforcement strategy rather than deal with individual cases of exemptions.

### **Analysis & Conclusion**

The overall impact of the recommendations of the Kelkar Committee report relating to Charitable Trusts and Institutions appears to emphasise on simplifying the procedures of the Income Tax Act related to the registration under specified sections and claiming deductions for the donations made to Charitable Trusts and Institutions. Now it is upto the Government that how far it takes up the suggestions of the Task report in the Finance Budget, 2003.