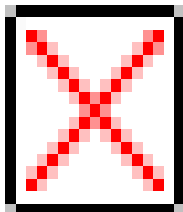


NPO Sector: Deciphering tax angle within legal wrangle!

THE POLICY LAB (TPL-07)

AUGUST 22, 2022

By J B Mohapatra



CONSIDER

for a moment the case of a not-for-profit-organization (NPO) incorporated to promote world peace which ends up planning and sponsoring public demonstrations and actively drums up support for commission of acts of civil disobedience in defiance of local ordinance resulting in breaches of public order; or a research foundation created for advancement of education and social awareness about comparative religion employing its chief promoter cum televangelist to air communally charged divisive views; or a religious charity using its resources ostensibly for mass conversion; or a NPO created for addressing the developmental needs of the under-privileged and promoting sustainable livelihood activities receiving funds for pursuing its objects from 'banned' outfits. Do these factors and characteristics encompassing among other things the motivational thrust of their objects, and strategy and modus of their operations determine the NPO's entitlement to income tax registration, if they are otherwise validly incorporated and adhere to the reporting requirements of other governing and applicable statutes?

While under the main source of general law of charity, a trust if it tends to induce commission of an offence or purpose of its incorporation is illegal or activities in furtherance of its objects are against public policy or substantially includes criminal misconduct, reducing these intents explicitly in to the tax statute has but been gradual and calibrated.

Prior to its amendment vide Finance Act (No 2) of 2019, procedure for fresh registration of a trust or an institution under section 12A of the Income Tax Act (IT Act) who has made an application under section 12A (a) or (aa) or (ab) was largely dependent on 2 factors: whether the activities the entity pursued were genuine, and whether such activities fell within the scope of its objects for which the entity had been incorporated. The provisions for fresh registration as per section 12AA(1) read as follows:

"12AA.

Â (1) The Principal Commissioner or Commissioner, on receipt of an application for registration of a trust or institution made under clause (a) or clause (aa)Â 27 [or clause (ab)] of sub-section (1) ofÂ section 12A, shall-

(a)Â call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf; and

(b)Â after satisfying himself about the objects of the trust or institution and the genuineness of its activities, he-

(i)Â shall pass an order in writing registering the trust or institution;

(ii)Â shall, if he is not so satisfied, pass an order in writing refusing to register the trust or institution,

and a copy of such order shall be sent to the applicant :

Provided

Â that no order under sub-clause (ii) shall be passed unless the applicant has been given a reasonable opportunity of being heard."

In similar manner, section 12AA(3) which read as follows, laid down the yardsticks for filtering out and cancelling non-genuine cases who had been previously registered:

"(3) Where a trust or an institution has been granted registration under clause (b) of sub-section (1) or has obtained registration at any time underÂ section 12AÂ as it stood before its amendment by the Finance (No. 2) Act, 1996 (33 of 1996) and subsequently the Principal Commissioner or Commissioner is satisfied that the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, he shall pass an order in writing cancelling the registration of such trust or institution:

ProvidedÂ

that no order under this sub-section shall be passed unless such trust or institution has been given a reasonable opportunity of being heard. "

Section 12AA(4) intended to link continuance or cancellation of registration to adherence or violation of certain conditions of section 13(1), which are (a) income applied to private religious purpose (b) income applied for particular religious community or caste (c) income applied for benefit of persons in charge of affairs of the entity such as author, founder, trustee and (d) investment out of trust funds in a manner contrary to modes as prescribed in section 11(5).

Changes to the contours of conditions to afford entitlement to registration to trusts and institutions by including among others the legality of objects and adherence to public policy while conducting the attendant activities came about in Finance Act (No 2) of 2019. One may notice reference to 'any other law' in the amendments effected in section 12AA(1) and section 12AA(4) as below:

"12AA.

(1) The Principal Commissioner or Commissioner, on receipt of an application for registration of a trust or institution made under clause (a) or clause (aa) or clause (ab) of sub-section (1) of Â section 12A, shall-

22 [(a) Â call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about,-

(i)Â the genuineness of activities of the trust or institution; and

(ii)Â the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects,

and may also make such inquiries as he may deem necessary in this behalf; and]

(b) after satisfying himself about the objects of the trust or institution and the genuineness of its activities, Â 23[as required under sub-clause (i) of clause (a) and compliance of the requirements under sub-clause (ii) of the said clause], he- 9

(i) shall pass an order in writing registering the trust or institution;

(ii) shall, if he is not so satisfied, pass an order in writing refusing to register the trust or institution,

and a copy of such order shall be sent to the applicant :

Provided that no order under sub-clause (i) shall be passed unless the applicant has been given a reasonable opportunity of being heard."

"(4) Without prejudice to the provisions of sub-section (3), where a trust or an institution has been granted registration under clause (b) of sub-section (1) or has obtained registration at any time under section 12A [as it stood before its amendment by the Finance (No. 2) Act, 1996 (33 of 1996)] and subsequently it is noticed that

24 [

(a) the activities of the trust or the institution are being carried out in a manner that the provisions of sections 11 and 12 do not apply to exclude either whole or any part of the income of such trust or institution due to operation of sub-section (1) of section 13; or

(b) the trust or institution has not complied with the requirement of any other law, as referred to in sub-clause (ii) of clause (a)

) of sub-section (1), and the order, direction or decree, by whatever name called, holding that such non-compliance has occurred, has either not been disputed or has attained finality,

then, the Principal Commissioner or the Commissioner may, by an order in writing, cancel the registration of such trust or institution:]

Provided

that the registration shall not be cancelled under this sub-section, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner."

The same set of conditions for according or refusing claims of fresh registration or renewal of registration as were available in amended section 12AA is also applicable in terms of newly inserted section 12AB with effect from 1-4-21. In essence, cancellation of registration to a trust or an institution, which has been registered earlier, is legally permissible under section 12AB(4) of the IT Act on the occurrence of a 'specified violation', which are (a) where income from property held under trust has been applied for objects other than the objects of the trust or institution (b) where conduction of business is not incidental to attainment of its objects or separate books of accounts are not maintained in respect of business which is incidental to attainment of its objects (c) where income from property held under trust is applied for private religious purpose and does not enure for benefit of the public (d) where income of a charitable trust is applied for benefit of any particular religious community or caste (e) where activity the entity pursues is non-genuine and in derogation of the conditions of registration and (f) where trust or institution has not complied with the requirement of any other law, and the order, direction, decree holding the fact of non-compliance has either not been disputed or has attained finality. In case of fresh application for registration as per section 12AB(1), the two factors warranting consideration are (a) whether the activities being pursued are genuine or not and (b) whether the requirements under any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects have been complied or not.

The only condition common to claim of fresh registration or continuation of registration of hither-to registered entity is admittedly compliance of the entity to requirements of 'any other law' which is material for the purpose of achieving its objects, and is by far the most fundamental rejig in administration of tax exempt entities keeping the domestic and international context and compulsions in mind.

The preamble of the UN Security Council Resolution 2129 (2013) states that the Council recognises

"the need for Member States to prevent the abuse of non-governmental, non-profit and charitable organisations by and for terrorists, and calling upon non-governmental, non-profit and charitable organisations to prevent and oppose as appropriate, attempts by terrorists to abuse their status, while recalling the importance of fully respecting the rights to freedom of expression and association of individuals in civil society and freedom of religion or belief, and noting the relevant recommendations and guidance documents of the Financial Action Task Force (FATF)."

FATF since 2002 has conducted numerous studies on locating vulnerabilities within the NPO sector and suggested measures to protect the integrity of the sector from abuse by elements supporting terrorist activity or through terror financing and putting in place systemic regulatory controls affording greater transparency and by strengthening internal control and risk mitigation architecture. UN Security Council Committee, which oversees the implementation of sanctions regime and decides upon designating individuals and entities who meet the listing criteria set out in relevant Resolutions, on its part, pursuant to UN Resolutions 1267 (1999), 1989 (2011) and 2253 (2015) has notified a total of 260 individuals and 89 entities (as on 19-2-21), who are engaged in financing, planning, facilitating, preparing or perpetrating acts and activities either by themselves or in conjunction with other entities for imperilling the rule of law and commission of offences of concern and against humanity. It eventually boils down to quality of systems and processes in a domestic jurisdiction to ascertain how many of these proscribed entities have clandestinely made ingress into a country's NPO sector to perpetuate their ultimate objects.

Sequestering the UN notified entities from making inroads into the domestic NPO sector by suitable regulatory screening of a country's own NPO database against the UN sanctions list no doubt satisfies an international obligation, but far greater challenges lie in coordinating the amended version of tax statute with the administration of 'any other law'. Trafficking in covid infants for illegal adoption, or running an orphanage without licence mandatory under Women and Children Institutions (Licencing) Act, or predatory proselytization in the name of charity are live instances which are both illegal and contrary to public policy. Amended position of law now makes it explicit that a trust can be voided at the very application stage or on a later date, if the objects of the trust are illegal or its resources have been employed to commission or perpetuate a crime defined by statute. Challenge before the tax authorities however would remain on ascertaining the real import of the formulation in section 12AB(1)(b)(i)(B), that is

"the compliance of such requirements of any other law for the time being in force by the trust or institution as are material for the purpose of achieving its objects".

A judicious determination of this aspect falling at the intersecting space between the tax statute and 'any other law' holds the key to realise the legislative intent behind the amendments and help establish a harmonised legal and institutional framework cutting across many statutes and their implementing arms.