Corporate Social Responsibility & Social Business Models in India

A Legal & Tax Perspective

November 2013

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We believe strongly in constant knowledge expansion and have developed dynamic Knowledge Management (‘KM’) and Continuing Education (‘CE’) programs, conducted both in-house and for select invitees. KM and CE programs cover key events, global and national trends as they unfold and examine case studies, debate and analyze emerging legal, regulatory and tax issues, serving as an effective forum for cross pollination of ideas.

Our trust-based, non-hierarchical, democratically managed organization that leverages research and knowledge to deliver premium services, high value, and a unique employer proposition has now been developed into a global case study and published by John Wiley & Sons, USA in a feature titled ‘Management by Trust in a Democratic Enterprise: A Law Firm Shapes Organizational Behavior to Create Competitive Advantage’ in the September 2009 issue of Global Business and Organizational Excellence (‘GBOE’).

Social sector practice is one of our most passionate practices. In our experience, a not-for-profit organization needs special care and prudence while setting up and operating in India through careful legal and tax planning that is aligned with the underlying social purpose. Utilizing our research, creativity and cross-border expertise, we have extensively helped foundations and various social sector entities. We have pioneered three very innovative strategies to advance social business in India: (i) setting up social impact funds for social businesses; (ii) developing strategies for facilitating mergers and acquisitions among non-profit organizations; and (iii) possibility of setting up a social stock exchange for trading of businesses which value social impact more than profitability.

We also provide expertise in setting up, structuring and designing non-profits entities and assist our clients in leveraging cross-border philanthropy, setting up Indian non-profit entities abroad, advice and assist on foreign contribution regulations and compliances, assist in seeking income-tax exemptions and provide our expertise in leveraging international tax treaties.

More recently we were recognized as Pacific Business Press: Winner of 'Asian-Counsel's Social Responsible Deals of the Year 2009'. Nishith Desai is also the recipient of Prof. Yunus "Social Business Pioneer of India" - 2010 award.

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1. Introduction

The gap between the "haves" and "have-nots" has attracted significant attention in the last two decades, specifically due to the efforts of forward-thinking Non-Governmental Organizations ("**NGOs**") (like those of Dr. Mohammad Yunus), high net-worth philanthropists (like Bill Gates and Warren Buffet) and business academics and consultants (like Dr. C.K. Prahalad and Dr. Philip Kotler). Businesses, governments, and NGOs are making collective efforts to reduce the gap leading to the emergence of innovative approaches under the broad umbrella called "Social Sector" (Figure 1). While all of the approaches contribute to the socio-economic development and well-being of society, in this paper we specifically focus on two highly relevant business approach towards social sector i.e. Social Business Models and Corporate Social Responsibility (CSR).

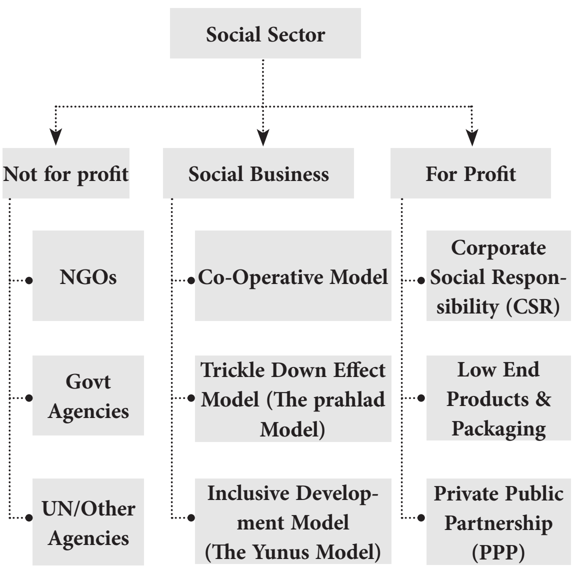

Figure 1: Social Sector Structure in India

The size of the social sector industry worldwide is huge but due to several verticals, such as education, health, resource development, etc., within this sector, it would be difficult to estimate the exact volume or revenue of the sector. Similarly, the social sector in India is also big and widely spread. In 2011, close to 7% of India's GDP (about USD 1,848 billion[1]) was spent on the social sector. In the last two decades, post liberalization and market reforms, governments have drastically reduced public spending on certain vital social sectors like education, health and agriculture to name a few. However, this has also paved the way for active and robust private sector investment in these sectors with the commercial side being addressed with maximum efficiency and reasonable productivity. The private sector in India is uniquely positioned to venture into the social sector and expand its consumer base by using its innovation and market expertise to create a sustainable future. Social sector practice in India is gaining wide importance with the advent of social business and entrepreneurial models. Post liberalization, the number of high-net-worth individuals ("**HNI**") in India is constantly on the rise with greater participation in philanthropic activities. A recent report showed that India is emerging as a leading player in private philanthropy and charitable giving with donations totaling between 0.3% and 0.4% of GDP.[2] The report also shows that most of the HNIs on an average donate 3-4% of their income to this sector. India is home to one of the fastest growing economies in the world; and churns out a high percentage of HNIs every year with an annual growth of 21% for such class. The HNI class includes a number of first generation entrepreneurs are relatively less experienced in philanthropy. But their inexperience does not discourage them and they are willing to invest in social ventures which generate desired outcomes. The HNI classes including a number of first generation entrepreneurs are relatively less experienced in philanthropy. But their inexperience does not discourage them and they are willing to invest in social ventures which generate desired outcomes.

1. Retrieved from http://www.tradingeconomics.com/india/gdp. Last visited on October 18, 2012.
2. Retrieved from http://www.bain.com/Images/REPORT_India_Philanthropy_Report_2012.pdf. Website last visited on December 08, 2012.

For social sector organizations to have access to finance of high value, it is important for them to have a robust internal governance mechanism. Although most of the contributions by donors are granted towards not-for-profit organizations that are not very large in scale, recently this sector is witnessing a giant leap towards private foundations run and administered under the able guidance of corporate houses. Almost 30% of the contribution to social sector is towards support network and religious and charitable trusts, most private foundations focus more on issues in the field of education, health and sanitation. The sector provides an exciting prospect for private foundations to pioneer a social entrepreneurial model based on a sound business model enabling stake-holders' socio-economic prosperity. Private foundations and corporate philanthropy not only contributes to social inclusion but also helps in sustaining the flow of investment and setting targets for the recipient organizations over several years with an aim to build their capabilities to achieve enhanced outcomes.

2. Social Business

A social business is a unique combination of traditional for-profit businesses, which focus solely on maximizing profit, and not-for-profit entities, which relies solely on charitable donations.[3] Social business came into existence to fill the void that was created, mainly, due to two factors:

- extremely slow pace of human development despite high growth and GDP;
- insufficient government participation in providing basic public, social and economic infrastructure to its less privileged citizens

A social business is not contrary to the idea of business, yet is different in its approach. Its main objective is to engage every stake-holder concerned and provide for a sustainable growth and/or development alternative based on sound and ethical business principles. The main idea of social business is to empower people, to grant them agency and to make them less dependent on externalities that are not within their control. Such empowerment provides 'capability'[4] and 'freedom' to those less privileged to choose their development path.

According to Dr. Yunus there are two kinds of social business. One being a non-loss, Non-dividend Company devoted to solving a social problem and owned by investors who re-invest all profits in expanding and improving the business. The second kind is a profit-making company owned by poor people, either directly or through a trust that is dedicated to a predefined social cause. Since profits that flow to poor people are alleviating poverty, such a business is by definition helping to solve a social problem.

Social business, as propounded by Dr. Yunus, advocates the following concepts:

i. The most important objective for a social business is to remove poverty and other socio-economic problems that society is beset with. The idea is to reduce or eradicate such problems using a business model.
ii. Such business models should not exist solely for profit maximization.
iii. The company engaged in social business will be able to achieve economic and financial sustainability.
iv. Investors would be eligible to only take back their investment money and not the dividend. Thus, profit stays with the company which is further invested for expansion and improvement of the business.
v. The company engaged in social business must be conscious towards environmental concerns.
vi. Workers should be paid at the market wage and provided with better workplace conditions.
vii. Such social business should be done with pleasure, dedication and with an objective.

However, when applying the Yunus principle into an Indian context[5] we should also keep in mind other determinants such as:

- Relevant or existing taxation and financial incentives for such social businesses or enterprises
- Existing economic conditions and purchasing power parity of the target group
- Legislations or regulatory framework supporting such social business models

Social business is different from social entrepreneurship or charitable trusts or a foundation established for social welfare. While social business is purely on a no-loss-non-dividend model with a social cause, social entrepreneurship is more individually driven either modeled on

3. Muhammad Yunus, *Building Social Business* (Public Affairs, New York, 2010).
4. Amartya Sen, *Development As Freedom* (Oxford University Press, Oxford, 1999).
5. CeiS, *Social Enterprise Business Model (CeiS, Glasgow, 2008). Available at:* http://www.ceis.org.uk/downloads/Resources%20and%20Publications/Enterprise%20and%20Communities/CEiSBusinessModelsReport-June2008.pdf. (Last visited October 28, 2012). Also see, Venturesome, *The Three Models of Social Enterprises* (Charities Aid Foundation, London, 2008). *Available at:* http://evpa.eu.com/wp-content/uploads/2010/11/CAF-Ventursome-3-Models-Of-Social-Enterprise-Part-1.pdf. (Last visited October 28, 2012).

for-profit or not-for-profit initiatives. Although the ultimate objective for both the kinds of entities would be same, the models on which they are structured are distinctly different.

Similarly, social business also differs a lot from a foundation. Foundations are incorporated largely to disburse funds and grant donations to various social sector organizations. Foundations don't generate any profit on their own and are mostly run by people with deep pockets. It could thus play a vital role in incubating and channelizing a social business. through venture philanthropy. Foundations could make strategic investments into social business projects based on muted returns. The Alternative Investment Regulation, 2012 ("**Regulation**") provides for investments into social business projects.

Figure 2: Social Business versus Not-for-Profit and For-Profit Businesses

Figure 2 shows how a social business borrows from both for-profit and not-for-profit entities.[6] It has to cover its full costs from its operations, and its owners are entitled to recover their invested money, but it is more cause than profit-driven. Its position in the lower right quadrant shows that it has both the potential to act as a change agent for the world, and sufficient business-like characteristics to ensure it survives to do so.

6. Yunus, Moingeon and Lehmann-Ortega, "Building Social Business Models: Lessons from the Grameen Experience", *Long Range Planning* 43 (2010) 309-325

3. Corporate Social Responsibility ("CSR")

The concept of CSR has never been defined or explained in a static manner; rather it has evolved over time. While its definition may differ locally, the concept revolves around business corporations performing obligations that one owes as a business enterprise towards people and society at large. CSR is an act that aims to bring positive changes to the lives of individuals; and transcends profit-and-loss issues for companies or individuals. CSR, therefore, is an act of moral, social and business responsibility to protect, preserve and nurture human values and promote socio-economic welfare. CSR is often understood interchangeably with philanthropy. While philanthropy can be said to be an important vehicle for carrying out welfare, it is never uniformly distributed across time and space within the social sector. CSR, to the contrary, is better organized, strategized and aims at bringing more uniformity and commitment to socio-economic causes and inclusive development. Till recently, there were no laws that governed CSR activities in India, however, policy makers have time and again looked into the importance of CSR as a tool to foster development. With that in mind, the Department of Public Enterprises, through its Circular dated 9th April, 2010 [F.No. 15(3)/2007-DPE(GM)], made it mandatory for all Central Public Sector Enterprises ("**CPSE**") to perform CSR activities out of its net profit. All such companies that are registered in India can undertake CSR activities. For private sector companies CSR is not mandatory but the Corporate Social Responsibility Voluntary Guidelines 2009 issued by the Ministry of Corporate Affairs ("**MCA**") is obligatory in nature. The Companies Act, 2013 (the "**Companies Act**") has made compliance of CSR provisions mandatory for all such companies registered under the Companies Act.

I. Evolution of Corporate Social Responsibility

Although there is no time period indicating the origin of CSR, one can safely assume that the need for employers to be more concerned for their employees must have arisen with the advent of a factory production system; i.e. with the advent of the industrial revolution, Factory owners had to take better care of their laborers since post industrial revolution they were free from feudalism and could now sell their labor power freely in the market. Thus, to remove ills perceived to be related with a factory system, factory owners started building schools, hospitals, churches, housing colonies etc. for the benefit of the laborers.[7] Such philanthropists (also early starters) and were Cornelius Vanderbilt and John D. Rockefeller, considered to be respectable personalities of that era.

Academic discourse on CSR started as late as the 1950s. In those days it was conceptualized as social responsibility, more so because it was believed that corporations have been vested with such power that every action and decision undertaken by them shall have an impact and/or influence on the lives of many.[8] Social responsibility according to Bowen[9] was "to pursue those policies, to make those lines of action which are desirable in terms of the objectives and values of our society".

The later phase proved more fruitful as many writers had begun writing on this subject more extensively and judiciously. One of the most important writers and a strong propagator of social responsibility, during that decade was Keith Davis. According to him "social responsibility is a nebulous idea and, hence, is defined in various ways. It is used here within a management context

7. Huzaifa Khorakiwala, Vijay Kapoor, et.al., *Essentials in Corporate Social Responsibility* (Wockhardt Foundation, Mumbai, 2010).
8. *Ibid*
9. Howard R. Bowen, *Social Responsibilities of the Businessman* (Harper and Row, New York, 1953)

to refer to businessmen's decision and actions taken for reasons at least partially beyond the firm's direct economic or technical interest". Social responsibility for corporations also means that business should be carried on in such a manner that the socio-economic needs of the society are fulfilled. Fredrick[10] thus understood and explained social responsibility for corporations and businessmen from a welfare-ist approach. Social responsibility vis-à-vis business would not mean doing away with competitiveness and profit motive but would also entail being more prudent and sincere towards social obligations which would expand economic and financial well-being of people affected by such business. Social responsibility, thus, would ask business professionals to be more prudent and analyze what positive or negative effects it had towards people and society at large if they were to make such a decision.

Globalization has brought a new set of challenges before us like never before. New markets and geographies have been conquered thus bringing along a large flow of foreign reserve, but at the same time it has also led to a widening of gulf between the haves and the haves-not. With this present form of market it becomes very pertinent for the business world to look beyond business and give a serious thought about how is it going to tackle the problem of hunger, illiteracy, deprivation and other such plights that our society is beset with. The market needs to re-think how to re-integrate those who have been dis-possessed and marginalized and the corporate world must double its efforts to address such issues.

We look at CSR not from a philanthropic or a charity point of view but from a more holistic view wherein the private sector would go hand in hand with the public sector to re-look and resolve the socio-economic issues that societies across the globe are facing today. Today's marketing model is far from just selling products to their consumers and cloaking more profits. Societies have now become more democratic, vigilante, politically conscious and more demanding towards accountability. It is also not a denying fact that the earth's resources are depleting but the demand has grown manifold. In such a scenario, a need to balance consumer's product satisfaction with his/her socio-economic wants which need to be respected in the corporate sector. It is only then that a company or an organization can claim to be a true corporate citizen and a true practitioner of corporate sustainability and responsibility.

CSR can be viewed from four facets, namely: economic, legal, ethical and philanthropic. According to Carroll, corporate profit maximization and doing good go hand in hand. It is completely possible for an organization to be successful in profiteering and also contribute to its socio-economic responsibilities. He went on to add that such good corporate ethos also instill a lot of confidence among share-holders. Such sentiment would also reflect positively on the company, which would then strive to set a higher benchmark for legal and ethical excellence.[11] CSR is considered an important tool to execute a company's objective in a strategized manner. A company investing in CSR and desirous of bringing in positive changes can achieve multiple positive externalities such as:

- Becoming a responsible corporate citizen
- Helping in retaining its employees due to increased employee satisfaction
- Customers feeling more related to the organization because of its CSR practices
- Helping in creating a good brand image

CSR, therefore, acts as a means to achieve certain corporate goals in an effective manner. CSR affects not only a company's brand image but also helps in bringing in a greater customer / consumer satisfaction and brand visibility across the board. Moreover, every business has its social and ethical stakes within the area it operates and, as

10. William C. Frederick, "The growing concern over business responsibilities", *California Management Review,* Vol. 29, pp 54-61 (1953)
11. Carroll A.B. (1979). "A three dimensional conceptual model of corporate performance", Academy of Management Review, Vol. 4, No. 4, pp. 497-505. (As cited in *supra* note 9)

responsible corporate citizens, it becomes doubly important to preserve, respect and nourish such societal stakes and responsibilities[12]; CSR obligates and, to an extent, mandates such responsibilities.

II. CSR and Recent Corporate Developments in India

In 2009, the MCA released a set of 'Voluntary Guidelines for CSR-2009' ("**Guidelines**") to incorporate a broader vision of CSR into Indian corporate law and aimed at promoting businesses contribution for well-being of stakeholders and society. The Guidelines set out six core elements for companies to address: (1) respect for all stakeholders; (2) ethical functioning; (3) respecting workers' rights and welfare; (4) respect for human rights; (5) respect for the environment and (6) activities for social and inclusive development. The central government has also provided guidelines for CSR and sustainability policies to be followed by central public sector enterprises. The Companies Act has been hailed as a game-changer by many as it contains, among other things, specific provisions on CSR.

i. CSR in Companies Act, 2013

Recently, with the promulgation of the Companies Act, an attempt on part of the Indian Government to foster corporate participation in growth, community participation and institutional philanthropy. The new Companies Act has introduced statutory provisions for responsible corporate governance in the India Inc. in the form of CSR provisions.[13]

ii. Legislative Intent

With a view to foster greater corporate participation in activities relating to social responsibility, the 21st Parliamentary Standing Committee on Finance on the Companies Bill, 2009 ("the **Standing Committee**") included CSR in the Guiding Principles and introduced CSR as a concept in the 2009 Bill ("**Bill**"), requiring certain class of companies to make disclosures about their CSR policies and activities undertaken thereunder. In response to the Committee's overwhelming concerns on the extent of CSR being undertaken by corporates and the need for a comprehensive CSR policy, the MCA agreed to introduce CSR provisions in the Bill, Further with the idea of inculcating the feel of CSR in the corporate regime, the MCA intended that in case any such company does not have adequate profits or is not in a position to spend prescribed amount on CSR activities, the directors would be required to give suitable disclosures / reasons in their report to the members. Thus, the basic intent behind introducing CSR through a statute was not to use the aforesaid provision as a severity, rather to enforce surety to achieve the desired goal of greater CSR participation and transparent disclosure by such companies.

On the issue of CSR, during evidence, the Committee raised their concerns on the role of corporates in discharging their social responsibilities. The MCA in its response, during evidence put forth the view that there shall be a mandatory CSR policy in each and every company beyond a certain limit, which are profitable and of a certain size; and that emphasis of the CSR provision in the Bill is on the disclosure method within the public domain. The issue of oversight mechanism by the MCA was not conceived within the Report and the whole emphasis was placed on putting the CSR policy in the law itself with voluntary regulation. Although the Bill underwent several versions since it was first introduced, the later committee i.e. the 57th Standing Committee Report accepted the reasoning and intent behind introduction of CSR in the Bill in its form and spirit. Thus, keeping in view the recommendations made by the previous committee, a new clause on CSR was included in the companies bill introduced

12. Sweta Singh, "Philanthropy to Corporate Social Responsibility: An Indian perspective". *Review of International Comparative Management,* Vol. 11, issue 5 (2010)
13. Ankita Srivastava and Dr. Milind Antani . *Corporate Social Responsibility- A Beyond Law Commitment.* Hotline, Nishith Desai Associates. Available at http://www.legalera.in/news-deals/articles-of-the-week/item/6976-corporate-social-responsibility-a-beyond-law-commitment*. Website last accessed on August 10, 2013

in 2011. The MCA, in principle, agreed to provide administrative flexibility to companies in choosing their CSR activities. The broader legislative intent behind CSR, as the Committee went on to suggest, was to further widen the scope of corporate governance and make it self-regulatory in nature.

iii. CSR Provisions

The Companies Act makes provision regarding CSR a mandatory legal requirement for India Inc. which is to be determined by a financial threshold. A company in this provision refers to an entity incorporated under the Companies Act or under the other previous company law.

A. Applicability

As prescribed under the Companies Act, the company satisfying any of the following criteria has to comply with the CSR provisions as stipulated under the Companies Act:

i. Net worth of INR 500 crore or more (USD 83.33Million; or
ii. Turnover of INR 1000 crore or more (USD 166.67 Million); or
iii. Net profit of INR 5 crore (USD 0.83 Million) or more

B. Constitution of a CSR Committee

The company which falls within the above criteria shall be required to constitute a Corporate Social Responsibility Committee (**"Committee"**) of the Board consisting of a minimum of three directors, out of which at least one director shall be an independent director.

C. Formulation of CSR Policy

The Committee shall formulate and recommend to the Board a CSR Policy which shall indicate the activities to be undertaken, recommend the amount of expenditure to be incurred on the activities referred, and monitor the CSR Policy of the company from time to time. The Board, after taking into account the recommendations made by the Committee, shall approve the CSR policy for the company.

D. CSR Activities

CSR activities which may be included by companies in their CSR Policies may relate to (i) eradicating extreme hunger and poverty; (ii) promotion of education; (iii) promoting gender equality and empowering women; (iv) reducing child mortality and improving maternal health; (v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases; (vi) ensuring environmental sustainability; (vii) employment enhancing vocational skills; (viii) social business projects; (ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and (x) such other matters as may be prescribed.

E. Allocation Towards CSR

The Board is required to ensure that the company spends, in every financial year, at least 2% of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its CSR Policy.

F. Disclosure and Reporting

The Board is required to provide in the General Meeting a report disclosing the composition of the Committee along with the details about the CSR policy developed.The contents of the policy shall also be placed on the company's website. Further, the statement of profit and loss shall record the amount of expenditure incurred on CSR activities.

G. Reasons for Non-Spending

The CSR provision follows a "comply or explain" approach, which requires the company to formulate a CSR policy and furnish details of spending of such amount. If the company does not have adequate profit or is not in a position to spend the prescribed amount on CSR, the Board is required to disclose and report the specific reasons for not spending the amount.

H. Penalty for Non-Disclosure

failure to report CSR spending or the reasons for its non-expenditure shall amount to contravention of Section 134 of the Companies Act, and the company shall be punishable with fine which shall not be less than INR fifty thousand rupees (USD seven hundred seventy-six) but which may extend to INR 2.5 Million (USD 38780 approximately) and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than INR fifty thousand rupees (USD 775 approximately) but which may extend to INR five lakh rupees (USD 7750 approximately), or both.

III. Key Points

i. Additional Taxes V. 2% of Net Profit

The lawmakers instead of simply taxing companies in the name of "social good" have mandated expenditures for the same. The intention has been to invoke the spirit of voluntary corporate philanthropy. The major advantage of mandating CSR spending, as opposed to levying additional taxes, is the preservation of the company's autonomy in selecting how its funds should be used and what CSR activity the company invests in. The corporation would have the leverage to invest its resources into a desired cause directly.

ii. Broad Scope of Schedule VII of the Companies Act

Traditionally, the majority of Indian companies have been investing in education and health, followed by environmental issues. Several social sector issues, such as creating jobs, providing employment enhancing vocational skills, resources for social business projects and promoting gender equality and empowering women, have not received much attention. Schedule VII of the Companies Act covers such aspects of social growth and will ultimately result in broadening the view of Indian companies, giving them diverse opportunities.

iii. All Corporates at a Level Playing Field

Several companies have been imbibing the case for social good in their operations long before CSR become a popular cause. In spite of having such successful examples, CSR in India is in a very nascent stage and is one of the least understood initiatives in India. By making it a mandatory requirement for Indian companies to do CSR spending, the Government will put all the companies at a level playing field by encouraging the companies to engage in CSR.

iv. Global Access to Companies

CSR is seen as an enabler for companies trying to access the global international markets, as spending on social development guarantees a positive public image. Apart from this, it helps in retaining staff, higher productivity, reduction in costs, increase in profitability, and improving customer satisfaction. A positive impact on a company's image due to CSR investment makes a company more acceptable and attractive as a global player.

v. Fiduciary Duty and Reinvesting

CSR ultimately leads to re-investing in communities where a company functions / operates. It builds reputational legitimacy, trust, and reciprocity from which companies benefit. It also makes the stakeholders feel that the company is extending its fiduciary duty to encompass their well-being. Companies engaging in CSR spending also create positive externalities which are recognized and appreciated by the local community.

The CSR provision is comprehensive in its approach; however, the absence of a penalty for non-compliance within the CSR provision is a potential setback because there is no deterrent force. Likewise, the absence of the powers, responsibilities and duties of the Committee for carrying out the CSR policy cannot foster the purpose of providing a framework to companies for the CSR road ahead. Further, the extent of liability of the Board is also not outlined in the Companies Act.

Section 135 mandates constitution of a mandatory CSR Committee consisting of three or more directors, out of which at least one director shall be an independent director. Section 149 of the Act lays down conditions for appointment of independent directors in listed public companies and is silent on appointment of independent director for other types of companies. Greater clarity is required for appointment of independent directors for unlisted companies or private companies or a One Person Company. In terms of disclosure and reporting of the CSR Policy of the company, apart from the shareholders, the Companies Act does not provide if there is a requirement to disclose or report the same before any regulatory authority.

IV. "Comply or Explain" Provision: the Ongoing Debate

Through the Act, companies are given a mandate to "ensure" that they spend at least two percent of their net profit towards CSR activities. CSR provisions in the Act has been welcomed by the industry, however, certain concerns with respect to the nature of the 'spending' mandate requires more clarity. Since the passage of the Act, there has been a constant debate regarding the severity of the 'spending' norm as prescribed under Section 135. The core debate concerns whether CSR is voluntary or mandatory in nature, and while the majoritarian view on the 'spending' provision suggests it to be mandatory in nature, a closer look into the provisions of Section 134 and 135 of the Companies Act along with variations of parliamentary discussions, suggestions and the legislative intent underlying the 'debate' clearly prescribe the nature of 'spending' to be voluntary.

The Committee was clear from the start that CSR provisions should not be mandatory considering compulsory CSR spending might be detrimental to interests of few. However, the disclosure requirement with respect to CSR policies and activities were always intended to be mandatory. Capturing the legislative intent, recommendations of the Committee were incorporated under Section 135 read with Schedule VII of the Companies Act.

CSR provision, contrary to many commentaries that have appeared in the press and public discourse, is not a legal cauldron imposed on the corporate sector.

Section 135(1) and (3) of the Act mandates the following:

i. Constitution of a CSR committee
ii. Formulation and recommendation to the Board, a CSR policy by the Committee indicating the activities to be undertaken by the company as specified in Schedule VII
iii. Recommending the amount of expenditure to be incurred on such activities
iv. Monitoring the CSR Policy of the company from time to time

A careful reading of Section 135(4) presents us a clearer picture. Section 135(4) has restored the faith in the Committee's legislative intent by making the 'spending' optional in nature. The said option can, however, be exercised subject to the mandatory reporting requirements. The company has to comply with the reporting requirement and provide explanation to the members in the event of non-expenditure by the company. Therefore, as per the Companies Act, the two percent spending on CSR is non-mandatory while reporting compliance about such non-expenditure is mandatory in nature.

Any failure to provide reason for non-expenditure or non-compliance of setting CSR standards in the financial statement shall warrant contravention of the provisions of Section 134, and the company shall be punishable with pecuniary fine and every officer who is in default shall be punishable with imprisonment and/or fine.

The Road Ahead

A strict reading of the Companies Act entails that CSR is not required to be followed by business structures such as limited liability partnerships and partnerships which are also profit making business entities. This is unlike other countries mandating CSR provisions; for example in the Philippines, large tax payers fall within the CSR provision, in Mauritius even banks, trusts and societies are covered and the UK includes subsidiaries of companies as well, based on a monetary threshold. The Companies Act should cover such business structures to carry out CSR activities as they are responsible towards the society they operate in.

V. Guidelines on CSR and Sustainability for Central Public Sector Enterprise

The Department of Public Enterprises ("**DPE**") through its Circular dated 9th April, 2010 [F.No. 15(3)/2007-DPE (GM)] made it mandatory for all Central Public Sector Enterprises ("**CPSEs**") to perform CSR activities out of its net profit. The DPE CSR Budget[14] will be mandatorily created through a Board Resolution as a percentage of net profit in the following manner:-

	Types of CPSEs Net Profit (Previous year)	Expenditure range for CSR in a Financial Year (% of profit)
I.	Less than INR 100 crore / 14.8 million USD 14.8	3%-5%
II.	INR 100 crore to 500 crore / 14.8 million USD to 74.4 million USD	2%-3% (subject to a minimum of 3 crores)
III.	500 crore and above / 74.4 million USD	0.5%- 2%

Table 1: Net profit v. CSR expenditure

The DPE issued Guidelines on Corporate Social Responsibility and Sustainability for Central Public Sector Enterprises which shall come into effect from April 1st, 2013 onwards. The earlier guidelines focused mainly on CSR activities for external stakeholders, i.e. how social causes and environmental concerns could be addressed through CSR projects funded by an earmarked budget for this purpose. Whereas, in the revised guidelines, CSR and sustainability agenda is perceived to be equally applicable to internal stakeholders and a company's corporate social responsibility is expected to cover even its routine business operations and activities. Accordingly, under the revised guidelines, CPSE are expected to formulate their policies with a balanced emphasis on all aspects of CSR and sustainability- equally with regard to their internal operations, activities and processes, as well as their response to externalities. In the revised guidelines, the thrust of CSR and Sustainability is clearly on capacity building, empowerment of communities, inclusive socio-economic growth, environment protection, promotion of green and energy efficient technologies, development of backward regions, and upliftment of the marginalized and under-privileged Sections of the society. Making it mandatory in the revised guidelines for CPSEs to take up at least one major project for development of a backward district and has the potential of contributing significantly in the long run to socio-economic growth in all backward regions of the country.

The guideline emphatically underscores the need for the top management of the public enterprises to be passionately involved in carrying forward the agenda of CSR and sustainability. The two tier

14. Retrieved from http://www.recindia.nic.in/download/DPE_Guidelines_CSR_Sust.pdf. Website last accessed on May 15, 2013

structure, comprising of a Board level committee headed by either the Chairman and/or Managing Director, or an Independent Director, and a group of officials headed by a senior executive of not less than one rank below the Board level–which the CPSEs are mandated to create, is expected to have the authority and influence to be able to steer the CSR and sustainability agenda of the company.

In the revised guidelines, the utility of a baseline survey in any need assessment study before taking up a CSR and sustainability project is recognized; but keeping in view the vocal protests of several CPSEs against making it a mandatory provision, a baseline survey is not insisted upon in every case. The CPSEs have been granted the flexibility to opt for other methods, including use of their own in-house expertise and resources for need assessment studies. The only requirement insisted upon in the revised guidelines is that the CPSEs should submit credible evidence of having made a fairly accurate assessment of the needs of to steer the CSR and sustainability agenda of the company.

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There is provision in the revised guidelines that the unutilized budget for CSR activities planned for a year will not lapse but will instead be carried forward to the next year. However, in order to ensure that the CPSEs take their corporate social responsibility seriously, some new provisions have been incorporated in the revised guidelines. Henceforth, CPSEs will have to disclose the reasons for not fully utilizing the budget allocated for CSR and sustainability activities planned for each year. The unspent amount of the budget allocated for CSR and sustainability activities for a year will have to be spent within the next two financial years, failing which, it would be transferred to a 'sustainability Fund' to be created separately for CSR and Sustainability activities.

Some changes have been made in the financial component of CSR and sustainability agenda. One, there is no separate allocation of budget for sustainable development, as was mandated earlier. Two, the slab of budgetary expenditure on CSR and sustainability activities for the CPSEs having profit after tax over INR 500 crore (74.4 million USD) in the previous year would now be from 1% - 2%. This is only a marginal change because, in any case, CPSEs are now advised to maximize their expenditure on CSR activities and move towards the higher end of their respective slabs of budget allocation for this purpose. Third, in the earlier guidelines, there was a provision of a minimum expenditure of INR 3 crore on CSR activities for CPSEs having a net profit of INR 100 – 500 crore (million USD 14.88 – 74.3). This created an anomalous situation vis-à-vis the CPSEs placed in the higher slab, having a net profit of over INR 500 crore (74.4 million USD), for which no minimum expenditure was specified in the earlier guidelines. The requirement of a minimum expenditure of INR 3 crore (0.46 million USD) has been removed in the revised guidelines. However, these CSR guidelines and especially the suggested slabs of budgetary allocation for CSR and sustainability activities would stand modified as and when the new Company Law brings in provisions in this regard, which would need to be followed by all companies including the CPSEs.

4. The Alternate Route

Section 135 of the Companies Act has re-defined the concept of CSR'.[15] Though the term CSR has not been defined in the Act, Schedule VII has identified nine areas that can be undertaken as CSR activities to fulfill the requirement of 2 % spent on such activities.[16] These nine areas include social business projects as part of the CSR activities that companies may undertake. The areas highlighted under Schedule VII of the Companies Act will be central to how companies would approach this obligation spending 2% of the average net profits for three preceding years towards CSR activities. Section 135 of the Act contemplates 'expenditure' by the company on CSR activities but falls short of explaining how the amount is to be spent. Section 135, if read conservatively, looks more philanthropic and might limit Indian companies to writing a cheque based on their net profits for CSR activities. CSR, when seen in a broader context, should mean bringing sustainable changes around a company's eco-system through core business performance and practice. CSR, therefore, should be seen as a mix of good governance and corporate philanthropy for a company but with a business and financial side to it as well.

Thus, 'investing' money rather than merely 'spending' money should be the core philosophy behind CSR. Typically, spending on CSR activities by companies doesn't envisage any financial return and such spending is directly proportional to company's annual profits/year which may not be uniform. However, such spending, when seen

15. 135. (1) Every company having a net worth of Indian rupees five hundred crore or more, or a turnover of Indian rupees one thousand crore or more or a net profit of Indian rupees five crore or more during any financial year shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.
(2) The Board's report under sub-Section (3) of Section 134 shall disclose the composition of the Corporate Social Responsibility Committee.
(3) The Corporate Social Responsibility Committee shall,-
(a) formulate and recommend to the Board a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII;
(b) recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
(c) monitor the Corporate Social Responsibility Policy of the company from time to time.
(4) The Board of every company referred to in sub-Section (1) shall,-
(a) after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such a manner as may be prescribed; and
(b) ensure that the activities as are included in Corporate Social Responsibility of the company are undertaken by the company.
(5) The Board of every company referred to in sub-Section (1), shall ensure that the company spends, in every financial year, at least two per cent. of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy:
Provided that the company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities:
Provided further that if the company fails to spend such amount, the Board shall, in its report made under clause (o) of sub-Section (3) of Section 134, specify the reasons for not spending the amount
Explanation- For the purposes of this Section "average net profit" shall be calculated in accordance with the provisions of Section 198.
16. Activities which may be included by companies in their Corporate Social Responsibility Policies under Schedule VII of the Companies Act:-
(i) eradicating extreme hunger and poverty;
(ii) promotion of education;
(iii) promoting gender equality and empowering women;
(iv) reducing child mortality and improving maternal health;
(v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
(vi) ensuring environmental sustainability;
(vii) employment enhancing vocational skills;
(viii) social business projects;
(ix) contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and;
(x) such other matters as may be prescribed.

as an investment, will create margins that can be reinforced into the company's assets for further scalability.

Since the Companies Act links CSR spending to profits of the company, the CSR needs to be strategic and de-linked to company's profit once an investment in such activity is made. Company's Act requirement of a formation of a Corporate Social Responsibility Committee to monitor CSR activities of a company will be a key way for companies to set out a strong strategy that links to their core business. Social business can act as a bridge between CSR activities and companies' core business strategy and also ensure that CSR activities are not relegated to the fringes of unrelated business that are purely philanthropic in nature with the least impact.

The Companies Act does not define social business and/or social business projects. A social business is not contrary to the idea of business but is different in its approach. Its main objective is to engage every stake-holder concerned and provide sustainable growth and/or development alternative based on sound and ethical business principles. Though there is no specific definition of a social business, various models of social business are prevalent, most common being Dr. Yunus' social business models. He has explained two kinds of social business. One being a non-loss, Non-dividend Company devoted to solving a social problem and owned by investors who are required to re-invest all profits in expanding and improving the business. The second kind is a profit-making company owned by poor people, either directly or through a trust, that is dedicated to a predefined social cause and profits that flow to poor people to help in alleviating poverty. Such a form of business, by its very definition, helps in solving social problems and should be considered as an integral component of social business projects. Social businesses are an emerging type of business which seeks to achieve social goals through the use of business techniques. Such enterprises draw on a wide range of funding sources both from public and private money in the form of grants, charitable donations and direct investments, but take a business form so they can draw on support from the financial markets.

Presently, the absence of any clear policy prescription for social business projects has hampered responsible investment; and not many companies have explored the need to invest in social business projects. SEBI has recently brought an all-in regulation that covers private collective investment devices under one omnibus regulation. Thus, collective investment devices have come into the fold of the new SEBI regulation on alternative investment funds.

The Regulation can play an enabling role for the spread of social business projects in India. Social businesses can achieve sustainable growth only when it draws on a wider range of investments from various financing sources. The 2% spending provision in the Companies Act for CSR activities can provide the synergy between social business, companies' margins and financial sustainability if invested as social venture funds under the Regulation. The Regulation may have a far reaching effect on social business projects as it can harmonize challenging issues of creating profit and yet providing goods and services to the masses at a reasonable cost.

Social venture, as per Section 2(*u*) of the Regulation, is defined as any set of activities that is formed with the purpose of promoting social welfare, solving social problems or providing social benefits. As per Section 2(*v*) of the Regulation, the "social venture fund" means an Alternative Investment Fund which invests primarily in securities or units of social ventures and which satisfies social performance norms laid down by the fund and whose investors may agree to receive restricted or muted returns. The definition of social business (as mentioned above) does not contemplate providing dividend to its investors, whereas a 'social venture fund' provides for restrictive or muted returns to its investors. It is expected that investors may accept returns on their investments which may be lower than the prevailing returns for similar investments. The idea of providing muted returns to investors would not color the fund with profit motives as the fund is created to facilitate re-investment of margins for further re-enforcement into social business projects. Such an arrangement would also enable the pooled vehicle to be self-sustaining in nature and independent of companies' balance-sheet or profit and loss. Thus, by applying the 2% of net profit of three preceding years on CSR activities, a social venture fund under the Regulation may be created. The said fund may also be termed as a social business project that can deliver a muted return, a high social return and limited downside risk using the capital earmarked for CSR.

CSR spending through investment in social venture funds can be useful in promoting the innovation of new business solutions as well as providing seed funding and incubation of breakthrough ideas and social enterprises. Social venture funds through the alternative route may also ensure that the 2% spent equates to the desired impact. Through this route, the risk of companies investing in social business projects that may have lesser impact or cross fertilization is also minimized. It is worthy to note that for CSR to take care of social issues as envisaged in the Bill, there is a need, at the policy level, to expand the meaning of 'social business projects'.

5. The Conventional Route to Charity in India

Under the existing laws, charitable activities can be carried out by all types of legal entities in India. Most of the companies in India have now started to engage themselves in CSR as well as voluntary activities, either through donations or through active participation on their own. In India, the choice of an entity to carry out such charitable activities becomes important because of tax implications. Incomes of charitable entities are exempt under the Income-Tax Act ("**ITA**"), and the three forms of charitable entities that exist in India are namely a society, trust and Section 25 corporation.

In India, charitable entities can be registered under the following legal instruments:

- Societies Registration Act, 1860
- Charitable and Religious Trust Act, 1920
- Section 25 of the Companies Act, 1956

Under the directives of these legislations, an organization engaged in voluntary work can carry out their activities as one of the following entities:

- Registered Society
- Section 25 company
- Public Trust

An organization can choose any of the above forms depending upon the purpose and mandate of the organization.

I. Registered Society

Seven or more persons are entitled to form a registered society under the Societies Registration Act, The organization so formed must be registered to carry out literary, scientific or charitable activities. In addition to the above Act, several states have also enacted their respective Acts and Rules, and registration is carried out by respective states where such organizations are located. Normally an organization registers in the concerned district where it operates, but, to have a state-wide scope of its operation, the organization needs to be registered with the registrar of societies.

II. Section 25 Company

Section 25 of the Companies Act, 1956 permits a company to register itself as a not-for-profit company with limited liability to its members. Provisions relating to not-for-profit companies i.e. Section 25 Companies have been incorporated under Section 8 of the new Act.

An association formed under Section 25 has the status of a body corporate or a limited company. It is registered under the Companies Act and is recognized as an independent entity. As it is a separate legal entity, the property of a Section 25 company vests in the company and law suits can be filed against the company itself. The members of the management committee enjoy similar powers as that of the board of directors. It is not necessary for a Section 25 company, limited by guarantee, to have any share capital. But if it has share capital it is subject to the same restriction relating to reduction of shares as a company limited by shares.[17] It does not have liberty to purchase its own shares as restricted under Section 77 of the Companies Act.

i. Distinctive Features of a Section 25 Company

Admission of Members	A governing body is constituted to govern the membership to a Section 25 company. Even firms can become members of Section 25 companies. This is again to encourage development of associations which promote social or charitable causes.

17. Sec 100, Companies Act 1956.

Directors	A Section 25 company need not seek the approval of the Central Government to increase or decrease the number of its directors.[18]
Meetings	A Section25 company need not hold four meetings of its Board of Directors every year. The Board of Directors, Executive Committee or Governing Committee of such companies shall hold at least one meeting every six months.[19] The company has to hold an Annual General Meeting (AGM) in each calendar year and file its Annual Returns with the Registrar of Companies ("**ROC**"). A Section 25 company need not hold its AGM during business hours or in the registered office. The meeting can be held even on a public holiday as Section 25 companies are exempted from complying with the requirements of Section 166 (2) of the Companies Act.[20]
Funding	Funds can be accepted in the form of donations from members of the company. The surplus generated by excess of receipts over and above the expenditure cannot be taxed as it does not qualify as "Income" as defined under the Income Tax Act.[21] Any voluntary contributions received by a Section 25 company are taxable as income.[22] The Board of Directors or the Governing Committee of a Section 25 company can take decisions regarding power to borrow money other than on debentures[23], power to invest funds of the company[24] and power to make loans[25] without passing a resolution in the Board meeting.[26] These companies are exempted from paying the fees specified with respect to several matters mentioned in Schedule X of the Companies Act to the ROC.[27]
Licensing	The license for incorporation of Section 25 company is granted by the central government. An organization having granted such license is allowed to drop the word "Limited" from its name. The license is granted subject to the following two conditions[28]: (1) the company should be formed for the promotion of commerce, art, science, religion, charity or any other useful object and (2) the company should apply its income in promoting its objects and must prohibit the payment of dividends to its members[29]
Exemption Under the Stamp Duty Act	Companies registered under Section 25 of the Companies Act 1956 need not have their Memorandum of Association ("**MOA**") and Articles of Association ("**AOA**") stamped under Article 39 of the Indian Stamp Act, 1899.[30]
Liabilities	If there is a breach of trust by the directors or the members, by utilizing the exemptions given to a Section 25 company for making personal profits or any act, which contravenes the provisions of Section 25 (1), then the central government may revoke the license given to that company.[31] Penalty has been provided for the contravention of alteration of the objects clause under Section 629-A. The liability of the members of a Section 25 company limited by guarantee extends only to a fixed sum specified in the MOA and beyond, which they cannot be called upon to contribute. The members of these companies are liable while they are members and within one year after they cease to be

18. Notification No. SO 2767 dated 5 August 1964.
19. Notification No. SO 1578 dated 1July 1961.
20. Notification No. SO 1578 dated 1July 1961.
21. *CIT, Bihar v. Bankipur Club Ltd,* (1997) 2 SCC 394.
22. Sec 2 (24),Income Tax Act 1961. Also ref Sec 2 (18) (aa), Income Tax Act 1961.
23. Sec 292 (1) (c), Companies Act 1956.
24. Sec 292 (1) (d), Companies Act 1956.
25. Sec 292 (1) (e), Companies Act 1956.
26. Notification No. SO 2767 dated 5 August 1964.
27. Notification No. SO 3879 dated 22 December 1962.
28. Avatar Singh, *Company Law* 51 (Eastern Book Company, Lucknow, 15th edn., Reprinted, 2009)
29. Section 25(1) and 25(3)
30. A. Ramaiya, *Guide to Companies Act,* (Wadhwa & Co. New Delhi, 2004) 443.
31. Sec 25 (8) (b), Companies Act 1956.

	a member of the company.[32] Each member undertakes to contribute such amount as he is entitled to contribute (i.e. the amount for which he has guaranteed). If default is made in holding an AGM[33] then the company will be punishable with fine.

Table 2: features of a Section 25 Company

ii. Registration Procedure for Section 25 Company

An application for registration under the prescribed form is to be before the ROC along with a fee of INR 500. The applicant may submit suitable names for the organization in order of preference before the ROC for approval. Confirmation of Athe availability of the desired name by the ROC should normally take 7 days or less. Once the name is approved by the ROC, the MOA and AOA are prepared, and an application to the ROC of Companies requesting for issue of an approval under Section 25 is made. The ROC, after scrutinizing the application, will grant the approval. After the receipt of the license/approval from the RoC, the MOA and AOA with certain documents are filed with the ROC. The ROC then issues a certificate of incorporation to the organization.

iii. Documents to be Filed Online

i. E-form 24A with digital signature
ii. Draft of the MOA and AOA
iii. Details such as name, address and occupation of the promoters
iv. List of companies/associations in which the promoters are directors or hold responsible position with the description of the position held
v. List of the proposed members of the Board of Directors
vi. The proposed source of income and the expenditure thereof
vii. A note on the proposed activities and also the past activities, if any.
viii. A statement of the grounds for making an application under Section 25. In this statement, a reference to the relevant clause in the MOA regarding the vision and mission of the proposed company should be made.
ix. In case of an existing society applying for conversion into a Section 25 company, audited statement of accounts and annual report of the society for the past two years in triplicate should be submitted.
x. A certified copy of the notice to be published in newspaper

iv. Alteration of Memorandum of Association

A body, in respect of which a license under Section 25 is in force, shall not alter the provisions of its MOA with respect to its objects, except with the previous approval of the central government obtained in writing. The central government may revoke the license of such a body if alteration is made without its approval.

III. Public Charitable Trust

Under the local laws in India, a trust can be formed either as a private or a public trust. Formation of a private trust is governed by the Indian Trust Act, 1882 (“**ITRA**”). However, the ITRA does not govern trusts of public charitable nature. Trusts of public charitable nature are governed under the Religious Endowment Act, 1863, the Charitable and Religious Act, 1920 and the Bombay Public Trust Act, 1950 ("**BPT Act**").[34]

To form a public charitable Trust, it is very important that the objects of the trust must be charitable in nature and to engage in activities for general public utility. The Charitable Endowment Act, 1890 defines ‘charitable purpose’ as a purpose for the relief of poor, education, medical relief

32. Sec 13 (3), Companies Act, 1956.
33. Sec 166 is applicable to *“every company”* and hence it is also applicable to a Sec 25 Co.
34. *Infra* note 38 at p.1102

and advancement of any other objects of general public utility but does not include a purpose which relates exclusively to religious teachings or worship.

Formation of a Trust is fairly simple but the statutory provisions, procedures and the laws relating to trusts need detailed study. Under the Indian laws, various kinds of private and public trusts can be formed. The ITRA is not applicable to a public charitable trust. A public trust is formed under general law with guidance drawn from the IITRA. The other relevant Acts are Religious Endowment Act, 1863, the Religious Trust Act, 1920 and the BPT Act. Although the ITRA applies to private trusts, the general principles on which its provisions are based may be applied to public trusts in the absence of any specific corresponding provision for public trusts. However, such provisions, when borrowed from the Indian Trusts Act, may lack enforceability when applied to public trusts.

A public charitable trust may be formed by any juristic person competent to contract or by any such person who has the power of disposition over a property and the capacity to create a trust for such property. Under Indian law, legal ownership of trust property vests in the trustees. Under the Indian Trusts Act (the general principles of which, as mentioned, may be applied to public trusts), the liability of the trustees is unlimited; unless it is specified in the trust deed that trustees are acting only in the capacity of trustees.

i. Ingredients of a Valid Trust

- There must be an author or settlor of the trust
- There must be a trustee
- There must be a beneficiary or beneficiaries
- There must be clearly delineated property
- The objects of the trust must be specific

ii. Is Written Trust Deed Compulsory?

It is always desirable to have a written trust deed even if not statutorily required as:

- a written trust deed is prima facie evidence of the existence of a trust;
- it facilitates devolution of trust property to the trust;
- it clearly specifies the trust objectives which enables one to ascertain whether the trust is charitable or otherwise;
- it is essential for the registration of conveyance of immovable property in name of the trust;
- it is essential to obtain registration under the Income-Tax Act to claim exemption from tax;
- it helps to control, regulate and manage the workings and operations of the trust;
- it lays down the procedure for appointment and removal of the trustee/s, his/their powers, rights and duties; and
- it prescribes the course of action to be followed in the event of any eventuality including dissolution of the trust.

iii. Is Registration Mandatory?

While registration of the trust deed in states that do not have a specific statute for public trusts is optional, it is recommended that the trust is registered under the Registration Act, 1908 ("**RA**"). Such registration is mandatory if the trust property has immoveable property. To enable the trust to seek tax exemptions, it should also be registered under the Income Tax Act, 1961. It should also be registered under the Foreign Contributions (Regulation) Act, 2010 ("**FCRA**") that enables it to receive foreign contributions.

- The trust deed should be filed with the sub-registrar of the registration department of the state where there is no state-specific public trust act, or with the Charity Commissioner under a state-specific statute such the BPT Act, if registration is sought in Maharashtra or Gujarat.
- If the trust property includes immoveable property, the trust deed should also be filed with the Registrar of Sub-Assurances who has jurisdiction in the area where the immovable trust property is situated.

35. Section 47 (1)(c)

Documents required for annual filing

- Annual returns
- Audited accounts

Other statutory obligations and/or compliances

- Registration under ITA
- Registration and/or permission under the FCRA to be able to receive foreign funds
- Employee welfare schemes as applicable
- Other local/municipal laws

6. Governance Issues in Charitable Trusts

I. Administration of Trust Property only by Proper Persons

Under trust law, the legal ownership of trust property vests in the trustees. To determine who would be considered a proper trustee in this regard, (in the absence of any explanation in the state-specific BPT Act, from where we could draw a parallel), we may refer to the ITRA which deals with private trusts. The principles of the ITRA may be applied to public trusts in the absence of any corresponding provisions in public trust statutes. Section 60 of the ITRA provides that "the beneficiary has a right (subject to provisions of the instrument of trust) that the trust property shall be properly protected and held and administered by **proper persons** and by a proper number of such persons". According to Explanation I to Section 60 of the ITRA, "a person domiciled abroad" is "not a proper person within the meaning of this term".

Further, while the Foreign Exchange Management Act, 1999 ("**FEMA**") is silent with regard to trusts or other not-for-profit entities (unless such entities set up a branch, a liaison office or a project office), we may examine certain provisions in the Foreign Exchange Management (Acquisition and transfer of immovable property in India) Regulations, 2000 ("**FEMA Regulations regarding Immovable Property**") with regard to a person of Indian origin resident outside India.

Clause 4 of the FEMA Regulations regarding Immovable Property provides that a person of Indian origin who is resident outside India, may acquire immovable property in India other than an agricultural property, plantation, or a farm house, provided that in case of acquisition of immovable property, the payment of purchase price, if any, shall be made out of (i) funds received in India through normal banking channels by way of inward remittance from any place outside India or (ii) funds held in any non-resident account maintained in accordance with the provisions of the Act and the regulations made by the Reserve Bank of India ("**RBI**"). There are also specific provisions with regard to the acquisition and transfer of immovable property in India by a person of Indian origin resident outside India in respect of gift, inheritance, etc. It is not clear whether the presence of a foreign trustee will affect the acquisition by the trustees of any immovable property even if it falls in any of the three categories mentioned above (agricultural property, plantation, or a farm house), as immovable trust property is required to be registered in the name of the trust and not in the names of individual trustees. Also, though the legal ownership of trust property is that of the trustees, such ownership is on behalf of the beneficiaries. In this case, the beneficiaries would be Indian residents. Further, any transaction in this regard would involve trust funds, not the trustees' individual financial resources. This concept has not been dealt with under the FEMA Regulations. Due to the lack of clarity on this issue, it is advisable to consult or ascertain the same from the appropriate authorities whether a foreign trustee is cause for any objection in this regard, as such foreign trustee would, as mentioned, be considered one of the legal owners of trust property along with the other trustees and subject to any liabilities that may arise thereof.

With respect to a foreign trustee dealing with investments made out of trust funds (trust funds may be invested in specified securities under Section 11 (5) of the ITA) u, If the trust has been registered as a charitable trust and granted tax exempt status under the Act oone may look into the restrictions imposed under the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 ("**FEMA Regulations on Security**"). While the investment of trust funds by a person resident outside India is not specifically covered by FEMA, it is nevertheless recommend that the approval of the RBI be taken for such purpose if a foreign trustee is on board.

II. Indian Courts to Administer Trust in Certain Cases

A trust, unlike a company or a society, has no independent legal existence. In the event of any breach of trust, it is the trustees who are held jointly and severally (individually) liable, and not the trust as an entity. Please note that a public trust is always open to public scrutiny and subject to court enquiry and direction.

Under Section 92 of the Code of Civil Procedure, 1908, (a central statute), any two or more interested persons or the Advocate General of the state where the public trust is registered may institute court proceedings for an enquiry into any alleged breach of trust, or where the direction of the court is deemed necessary for the administration of the trust, or to institute a suit for a court decree for specified purposes.

In addition, the Charitable and Religious Trusts Act, 1920 (also a central statute), empowers any person having an interest to apply to the courts by petition to obtain the following: (i) directions to the trustees to furnish particulars about the trust, its objects and its management, both administrative and financial; (ii) directions that the accounts of the trust be examined and audited within a limited period of three years prior to the date of the petition.

Since a public trust is subject to public scrutiny and court enquiry and direction, all the trustees, including the foreign trustee, would be subject to such public scrutiny and the jurisdiction of Indian courts. While one trustee may be authorized by the other trustees to appear on their behalf for any court proceeding, any liability in respect of the trust (unless otherwise proved) will fall jointly and severally on all the trustees.

From the point of view of best practices in governance, a trustee acts in a fiduciary capacity and has certain responsibilities and obligations regarding the operation of the trust. While facilities such as teleconferencing or video conferencing may be used optimally by a foreign trustee, including for attendance of board meetings, close monitoring of the trust operations will present some difficulty to a foreign trustee not resident in the country where the trust is registered. As mentioned earlier, under ITR a person not resident in India is not considered a "proper person" to be entrusted with trust property. Moreover, under Section 47 of the BPT, ("Power of Charity Commissioner to appoint, suspend, remove or discharge trustees and to vest property in new trustees"), a trustee may be suspended, removed or discharged if he "leaves India for the purpose of residing abroad"[35], or if he is "absent for a continuous period of six months without the leave of the Charity Commissioner".[36] While the BPT Act applies only to Maharashtra and Gujarat and is not enforceable against a trust registered elsewhere in India, the principles underlying its provisions may be relied upon or referred to for general guidelines on public trusts in India. An absentee trustee may trigger an enquiry by the authorities or by any interested member of the public, which could lead to a court enquiry into the governance and management of the trust.

While there is no specific law against the appointment of foreign trustees in a public trust, the BPT Act and the ITRA do specifically exclude a person residing abroad. While the provisions under the FEMA Regulations present a grey area, one may nevertheless refer to such regulations by way of abundant caution as it concerns a person of Indian origin and/or a person not resident in India. Appointment of a foreign trustee, therefore, may have legal, regulatory and compliance issues.

36. Section 47(1)(b)

7. Administration of Not-For-Profit Entities Incorporated Outside India

I. Indian Operations Through Branch Office/Liaison Office

A foreign non-profit entity being incorporated outside India cannot be treated as an Indian non-profit entity. All foreign non-profit entities need to take prior approval from RBI under the provisions of the FEMA. It is interesting to note that FERA did not have any provision for prior approval for setting up branch / liaison offices by NGOs in India. They could simply seek a 'letter of no objection certificates' from RBI with no time frame stating the duration or longevity for such NOCs. Such approvals were mostly open-ended with almost no regulation. After the enactment of FEMA, the law is very categorical and clear about the legal formalities required to be complied by a foreign non-profit entity. Foreign non-profit entities seeking to establish its branch/ liaison office in India are generally granted such permission for three years only. Thus, under the present scheme of things foreign non-profit entities do not have an array of legal options to choose from. One available option is to set up a liaison office after obtaining the requisite approval from the RBI. With effect from June 1, 2000, all foreign non-profit entities, desirous of operating in India, are allowed to open liaison / branch offices by taking prior approval from the RBI.[37] It may also be noted that after receiving an approval from RBI for setting up a liaison office, the foreign office (which is an incorporated company) is also required to register itself with the ROC, New Delhi.

As per the Notification No.22/2000, dated 3 March 2000, no person resident outside India shall establish an office without prior approval of RBI. The updated master circular[38] on establishment of liaison / branch office was issued by RBI dated 1st July, 2011.

II. Choice of Entity for Setting up a Charitable Entity

It would be a little difficult to choose from among three existing legal instruments for registration although each one of them has distinct advantages and disadvantages. Disadvantages, though, may not be too contrasting or alarmingly serious for us to recommend any one form of registration. Registration of a company would be more professional with an organized set of work and human resources. However, compliances would also be manifold. Registering a trust would be the simplest way with much less paper work and lesser procedural formalities when compared to the former. Registration as a society would be a mix of both as it entails less paper/compliance work than a Section 25 company.

III. Prevention of Money Laundering Act (PMLA), 2002

By virtue of an amendment to the Prevention of Money Laundering Act (PMLA), 2002, notified in the Official Gazette on 12th November 2009, all NGOs and religious organizations have been included within the purview of the PMLA. Now onwards, NGOs including religious organizations will have to maintain details of the donors under the KYC norms. As per the amended rules, all transactions involving receipts by non-profit organizations of value more than Indian rupees ten lakh, or its equivalent in foreign currency, shall be subjected to the provisions of PMLA. In other words, complete details of the donor have to be provided in case of donations or receipts in excess of INR 10 lakh.

37. *Infra* note 38 at p.1295
38. RBI Master Circular **on Establishment of Liaison/Branch/Project Offices in India by Foreign Entities:** RBI/2011-12/3, Master Circular No. 03/2011-12 (updated as on January 30, 2012), dated July 01, 2011.

It may be noted that by virtue of the amendment it may not be possible to take large anonymous donations since, under the PMLA, it is necessary to provide the details of the donor, particularly in case of foreign receipts. Therefore, religious organizations which are not covered under Section 115BBC of ITA will also be covered under the Prevention of Money Laundering Act, 2012.[39]

39. Manoj Fogla, *Taxation of Trusts and NGOs* 1274 (Taxmann, New Delhi, 12th edn., 2012)

8. Foreign Contribution Regulation Act, 2010

FCRA is a non-fiscal statute with the object "to consolidate the law relating to the acceptance and utilization of foreign contribution or foreign hospitality by certain individuals or associations or companies and to prohibit acceptance and utilization of foreign hospitality for any activities detrimental to the national interest and for matters concerned therewith or incidental thereto". The core objective of the legislation seems to be to prohibit activities detrimental to national interest. FCRA covers both profit and non-profit entities as well as persons in sensitive government position, political parties and persons associated with news media.

Foreign contribution is defined to mean any donation, delivery or transfer made by a foreign source of any article, currency (whether Indian or foreign) or any security. Thus, the definition of contribution is very wide both in terms of coverage and mode of transfer of the assets in question. It brings within its ambit not only money but every asset transferred from a foreign source to an Indian non-profit entity. The Ministry of Home Affairs (“**MHA**”), Government of India, which oversees implementation of FCRA provisions, imputes a very wide interpretation of the term ‘contribution’ to cover any direct or indirect receipt from a foreign source. Even the definition of ‘foreign source’ is given a very wide import under the Act and it becomes very difficult for foreign citizens to even participate indirectly in the charitable activities of not-for-profit entities in India. Under the new Act, not-for-profit entities receiving foreign funds are not permitted to defray more than 50% of the foreign contribution to meet administrative expenses. This has resulted in an indirect control by the MHA over the operational autonomy on the functioning of such entities.

While there is no specific bar in law against a foreign national serving on the board of trustees of a public trust registered in India, there is a degree of sensitivity regarding the grant of approval for acceptance of foreign contributions under the Act. The FCRA is not a fiscal statute, but an act passed for the purposes of internal security regulated by the MHA. The presence of a foreign trustee in a public trust could lead to greater scrutiny, leading to delays in the grant of FCRA approval, or even rejection of the application for registration.

In this context, it is worthy to note that in the list titled "Common Grounds for Rejection" for the grant of FCRA approval (posted on the website of the MHA, http://www.mha.nic.in/fcra.htm) one of the grounds mentioned is: "If any of the office bearers / trustees, including the chief functionary, is a foreign national, **other than of Indian origin**".

"Indian origin" is neither defined in the FCRA nor in the Citizenship Act, 1955. Reliance, therefore, must be placed on Section 2 (c) of FEMA Regulations regarding Immovable Property for the definition of a person of Indian origin, which is as follows:

"An individual (not being a citizen of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Nepal or Bhutan) who

i. at any time held an Indian passport; or
ii. who or either of whose father or whose grandfather was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955."

It has been reported that as a matter of internal practice, MHA is reluctant to allow registrations to not-for-profit entities with foreigners on board. It is however unclear whether the FCRA authorities, in practice, distinguish between foreign nationals of non-Indian origin and foreign nationals of Indian origin.

It may be noted that the onus of getting registered under FCRA lies on the recipient and therefore, before accepting foreign contribution, it is the responsibility of the association to ensure all the requisite formalities are complied with and registration is granted before accepting any foreign exchange.

Time Limit for Making Application for FCRA Registration

No specific time limit has been provided under FCRA for making an application, unlike ITA, which requires an organization to apply within one year from its creation or registration under Section 12A. Normally FCRA is granted after three years of active existence, therefore; the application should be made after three years, though nothing in the Act prevents an organization from making such application earlier. Based on an interpretation of various applicable provisions of law, and decided case law, an application for registration under FCRA can be filed at any time after the registration of the organization. But, in practice an organization with a considerable history of activities has a greater chance of convincing the FCRA authorities with regard to the relevance of their purpose.

9. Taxation of Not-For-Profit Entities in India

India being a huge country both in terms of population and size has always been home to social enterprise across time and space. The social sector enterprise caters to a large part of its population either in the form of charity / philanthropy or voluntary activity or any other activity of social importance. Such activity becomes even more important because the State needs to be supported and supplemented by non-state actors in areas of policy polity and welfare initiatives and the socio-economic wellbeing of people concerned. Considering the recent electoral and social movements by the civil society organizations (**"CSOs"**) and non-for-profit entities in India, it would not be wrong to admit that the present sector has become one of the most important pillars of development in India. In India, organizations engaged in social service and social welfare may exist either as a trust or a society or a Section 25 company. One of the most important criteria that often distinguish non-profit from business entities are its 'charitable objectives'.

Over the years, the social sector has witnessed a spurt in donations and grant-in aid from domestic and foreign sources. And whereas most of such donations have been made towards not-for-profit sectors, reasonable funding have come for social enterprises as well. Social sector, therefore, is witnessing a positive involvement of multiple players from across different sectors, geographies and markets. This sector is not devoid of challenges such as issues concerning regulations and tax, issues concerning greater transparency and accountability, and most importantly, issues concerning utilization of foreign funds by domestic recipients. To channelize social sector efficiently one needs to carry out structural reform in a more sustainable manner so that it has a crowding-in effect for philanthropy and social business, fostering entrepreneurial engagements and investments into this sector.

Trusts and charitable institutions come under the concurrent list of Article 246 of the Indian constitution. Thus, the State as well as the Union have the authority to govern and frame rules for governing such entities. ITA being a federal legislation governs taxation issues concerning public trusts and charitable institutions in India.

I. Charitable Purpose: Definition

Under Section 2(15) of the ITA, 1961 "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 The above definition also includes an act of "advancement of any other object of general public utility", subject to the condition that no business activity or trade or commerce should be carried out for a fee or for any other consideration in the name of charity. Also, the proviso on trade, commerce or business related activity shall not apply if the gross amount is less than or equal to Indian rupees twenty five lakh. The upper cap of Indian rupees 25 lakh shall apply in relation to the assessment year 2012-13 and the subsequent year.

For the purpose of income-tax registration and availing exemption under Section 11 of ITA, it is of utmost importance that the criteria of 'charitable purpose', as laid down in Section 2(15), be strictly adhered to. The above definition becomes doubly important because of the insertion of the clause *"the advancement of any other object of general public utility";* form now onwards the applicability and scope of the definition and understanding of "charitable purpose" will have wider significance with regard to certain tax benefits and exemptions thereunder. In a very recent case of *DIT v. Chembur Gymkhana*[40] the ITAT held that definition of the expression "charitable purpose" in Section 2(15) includes inter alia, "any other object of general public utility" and 'general public' would not necessarily mean the entire public. The Tribunal held that trustees for the said trust can be drawn from a diverse cross Section of the public at large and would not be meant for a group or a private family. It is a settled principle of law that the primary or dominant purpose of the institution must be charitable. The test to be applied is whether the object which is pursued is of the main or primary object or whether it is ancillary to a dominant object. The word 'general' in the said expression means pertaining to a whole class. Therefore, advancement of any object of benefit to the public or a Section of the public, as distinguished from benefit to an individual or a group of individuals, would be a charitable purpose. If the primary or predominant object of an institution is charitable, any other object, which might not be charitable but which is ancillary or incidental to the dominant purpose, would not prevent the institution from being a valid charity. A careful reading of Section 2(15) clearly indicates that, while profit is permissible for non-profit entities, profiteering is not. Profit generated by the charitable organization shall not have any adverse effect on its charitable nature but the reverse may also be true.

The ITAT Delhi Tribunal has, in the case of *ITO v Moradabad Development Authority*[41], held that if a Section 25 company is incorporated for the activity of construction and sale of immovable property then such activity should be construed as 'business' on its face value. Even if the business is carried on continuously in an organized manner with a set purpose, it will not be construed as a 'business' if it is carried out with a view to earning profit so as to use the profit for the object of the trust, i.e. urban town planning and development. However, if the said activity is incidental to its main object then the incidence of tax is lifted if separate books of accounts are maintained in respect of such business.

Thus, if the motive of a non-profit entity is to solely make profit under the garb of Section 2(15), then the veil can be lifted and its 'charitable nature' can be questioned. The CBDT issued an explanatory circular dated 19th December 2008[42] clarifying that the purpose to create a residuary class of non-profit entities under Section 2(15) was solely to ensure that no commercial activities are carried out in the name of charity and the State does not lose out on tax claims. The definition, however, only includes entities falling under the residuary category while dominant category entities are exempt from tax incidence even if they carry business activities in furtherance of their charitable work. Moreover, entities falling under the dominant category may also have incidental and ancillary forms of business activities and they would not be hit by residual category proviso.

It seems that the distinction as enunciated in Section 2(15) is violative of Article 14 of the Indian constitution because it makes an unreasonable distinction between residual category organizations carrying "any other object of general public utility" and the former. Neither ITA nor the General Clauses Act, 1897 define what constitutes "general public utility" therefore, merely relying on the administrative understanding of "general public utility", an organization seeking registration under Section 12AA might run into a lot of subjectivity. Moreover, the definition presumes that only the residual category entities might misuse the charitable status and tax exemptions but what it fails to recognize is that such misuse and misappropriation may also happen with non-residual category entities as well. Although the courts and policy makers have been more accepting towards discriminatory provisions concerning tax legislations, it would be highly implausible to ignore the (un) constitutionality of this certain provision in the ITA.

In S*hree Ram Krishna Dalmia v Justice S.R. Tendolkar*[43], the Apex court observed that constitutional proprietary and validity of an enactment is presumed and the burden of proof shifts upon someone who thinks otherwise. The

40. [2012] 251 CTR (Bom) 145
41. [2012] 145 TTJ 746 (Delhi)(Trib.)
42. Circular No. 11/2008, F. No. 134/34/2008-TPL
43. AIR 1958 SC 538

Apex court further added that the 'presumption' test for constitutionality would not be valid for such provisions which make a distinction through discrimination in favor or against any class [..... thus, 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."][44]. The Apex court in the case of *Arun Kumar v. Union of India*[45] observed that discrimination under Article 14 of the constitution should be made on the basis of *intelligible differentia* and then only can such discrimination not be hit by illegality or invalidity.

Thus, a particular class of non-profit entities runs the risk of losing its exemption if it carries out or is in the nature of any trade, commerce or business irrespective of whether such activities were incidental or ancillary to its main activity. Therefore such entities would not come under the purview of Section 11, 12 and 13 for tax benefit purposes.[46]

The Apex court in *Thanthi Trust Case*[47] held that no tax implication would arise if the income generated by the trust is completely used for charitable purpose. The Delhi High Court in the case of *Institute of Chartered Accountants of India v. DGIT(E)*[48] held that a broad understanding of 'business' should not be used to understand the first proviso of Section 2(15). For the purpose of this Section an activity would be treated as 'business' only when it is carried out with a profit motive. The question of determining what kind of activity would tantamount to a 'business' would depend on the nature of execution of such business. If sound business principles were applied with an intention of continuity then such activities would be termed as a 'business'.

A non-profit entity falling under the residuary proviso shall lose its exemption status for that particular year if the gross receipts from trade surpass the amount specified in Section 2(15). The Assessing Officer cannot question the existence of charitable nature; instead she/he has the power to deny the exemption that the charitable entity would have otherwise been entitled to for that particular year.[49] The exemption shall be denied only when the business exceeds INR 25 lakh cap (USD 38,402). Denial of exemption would not mean that the said entity will cease being constituted as an entity incorporated for charitable purposes. It can be stripped of its charitable purpose only when the Commissioner of Income-tax withdraws the same under Section 12AA(3). Thus, all such entities, save those mentioned in the residuary proviso, are entitled to carry on incidental and ancillary business activities and the gross receipts cap of Indian rupees 25 lakh is not applicable for them.[50]

II. Income Under Section 11(1)

The word 'total income' as enshrined in Section 11(1) should not be assigned the meaning of the term 'total income' as used in Section 2(45). Board Circular No. 2-P(LLX-5), dated 15th May 1963 also clarifies that "it would, accordingly, be incorrect to assign to the word "income", used in Section 11(1)(a), the same meaning as has been specifically assigned to the expression "total income" vide Section 2(45).[51] Section 11(1)(a) specifies that income exempted from tax refers to the words *"income derived from property held under trust',* which raises a question whether 'income from property' and 'income from organization' is different. Although this Section contains the

44. *Supra* note 38 at p.61
45. (2006) 286 ITR 89
46. *Supra* note 38 at p.51
47. (2001) 247 ITR 785
48. (2011) 245 CTR 0541
49. In the case of *Rajasthan Housing Board v. Commissioner of Income-tax, Jaipur-II [2012]* 51 SOT 383 (Jaipur-Trib.) the Tribunal held that the Assessing officer has the authority to decide whether the assesse should be allowed exemption under Section 11 but his/her (non) allow-ability shall have no bearing on granting of registration u/s 12AA of the Income-tax Act.
50. *Supra* note 42 at p.39
51. *Supra* note 42 at p.413

term 'property', it should not mean that income should come only from property held under the trust. 'Income' would include all income of a trust arising out of its own sources, from external sources and from properties movables as well as immovable. Thus, income from all such properties would be entitled to exemption. As observed by the Privy Council and copied here (verbatim):

"....the reference to the term 'property' does not necessarily mean certain movable or immovable assets in the name of the organization from which the income is to be derived. The goodwill of the organization by virtue of which donations are raised can also be considered as property. Similarly, all lawful income would be considered for the purposes of Section 11 subject to other provisions."[52]

Income of a charitable organization is not required to be computed under the different heads as specified under Section 14 of the ITA since the income is required to arrive in the normal commercial manner therefore, complying with the provisions of Section 14 does not seem to have been envisaged for charitable organizations. Chargeability of income-tax arises only when trust is unable to apply 85% of its income for charitable purposes or loses its exemption for some other non-compliance of the provisions.

III. Registration Under Section 12AA

It is mandatory for all voluntary organizations, whether it is a trust, society or company, to be registered under Section 12AA of the ITA to avail the benefits prescribed under Section 11 and 12 respectively. The benefit is also subject to the condition that the organization seeking registration must obtain an audit report where the income of the organization exceeds the maximum amount *which is not chargeable to income-tax in any previous year.*

Procedure for applying for 12AA registration

Organizations seeking registration are required to apply in Form No. 10A as per rule 17A of the Income-tax Rules in duplicate. The following documents are required to be enclosed along with the application:

i. The original instrument along with the certified true copy of the original
ii. For a registered society, documents containing bye-laws along with its object clause and the Registration Certificate should be enclosed at the time of registration
iii. For a Section 25 company, the MOA and Articles of AOA along with the certificate of incorporation to be enclosed, and
iv. Statement of accounts of three previous years. And where the organization was not incorporated during previous three years then copies of accounts of lesser number of years may be submitted.[53]

In *New Life in Christ Evangelistic Association v CIT*[54], the court held that in order to get tax benefits under Section 11 and 12 of the ITA, registration under Section 12A is mandatory. However, a mere registration cannot be construed to be an entitlement towards tax exemptions.[55] The application is to be made to the Commissioner of Income-tax in whose jurisdiction the organization is located. And for organizations located in four metropolitan cities of Kolkata, Delhi, Chennai and Mumbai, the application for registration is to be made before the Director of Income-tax (Exemptions). The time-limit for making an application is one year from the date of creation of a trust or establishment of an institution, whichever is later. It is incumbent upon the authority to make an order in writing within six months from the end of the month in which the application is made.

In the case of *Society for the Promotion of Education, Adventure Sport & Conservation of*

52. India Spinners Association v. CIT [1944] 12 ITR 482
53. *Supra* note 38 at pp.178-179
54. [2000] 246 ITR 532 (Mad.)
55. *M. Visveesvaraya Industrial Research & Development Centre v. ITAT* [2001] 251 ITR 852 (Bom.)

Environment v CIT[56] the Allahabad High Court held that after the statutory limitation period of six months is over, the Commissioner or the Director (Exemptions), whichever the case may be, becomes *functus officio* and non-consideration of the registration application within the time as specified in Section 12AA(2) would result in deemed registration.

In a very recent case (*Tishir Shiskha Prasar Samiti v. CIT*[57]), the ITAT Tribunal (Agra) held that during the stage of registration, before the CIT/DIT (E), Section 12A/12AA of ITA does not envisage any requirement to ascertain whether the trust or organization is eligible for income or not.[58] Thus, at the time of considering the application for registration, one need not look into application of income, accumulation of income or its entitlement to the benefits of Section 11 and 12 of the Act.[59]

In the case of *Dy. DIT v. Kottukaran Foundation*[60] the Tribunal held that mere registration will not automatically grant exemptions under Sections 11 and 12. Registration under Section 12A is only to identify the institution and the assessee has to establish that the income from property held under trust was applied for charitable purpose within the meaning of Section 2(15). Merely conducting classes for open university/distance education cannot be construed as charitable activity within the meaning of Section 2(15).

As per ITA, non-profit entities can be registered under Section 12A as well as 10(23C)(vi). The latter Section is silent on whether application and usage of funds outside India for charitable purposes would be exempt from tax. And whereas Section 11(1)(c) clearly mentions "in India", no such restrictive clause is found in Section 10(23C)(vi) of the Act. The issue that comes to the forefront is whether entities incorporated under Section 10(23C)(vi) can have all its charitable activities outside India and claim exemption as well. The Apex Court[61] opined that such non-profit entities should have the majority of its charitable work in India and 10(23C)(vi) would not prevent it from applying its income to charitable purposes abroad. However, to avail tax exemptions, the dominant purpose and activity should remain in India.[62] More recently, the High Court of Delhi in the case of *Director of Income-tax (Exemption) v. National Association of Software & Services Companies*[63] has also held that income of the trust should not only be applied for charitable purposes, but also be applied in India to such purposes.

If the trust deed contains activities to be carried outside India then the provisions of Section 11(1)(c) can be invoked in the case of that trust actually incurring expenditure on charitable work outside India. A mere mention or incorporation of any such clause would not render the trust deed to lose out on exemptions. To invite forfeiture of exemption, activities must be carried outside the territory of India. The Apex court has also held that the *situs* of the property held by the trust is not important for the purpose of assessment of tax, what becomes relevant is that the public purpose of charitable nature should be in India.[64] Application of income for charitable purposes

56. [2008] 171 Taxman 113 (All.)
57. [2012] 21 taxmann.com 525 (Agra-Trib.)
58. *Supra* Para 9.4: "........the language of the Section 12AA does not show that in order to be able to get registration under Section 12A/12AA, there is necessity of first establishing how the concerned Samiti or Institution or, as the case may be, the society would be able to claim the exemptions under Section 11 or 12. The question of exemptions under Sections 11 and 12 would come only when the said exemptions are claimed by the Samiti or society at the time when it is assessed to tax. To consider whether the said society would be entitled to the benefits under Sections 11 and 12 would be prejudging the issue before the grant of certificate. At the stage of the grant of certificate under Section 12A/12AA, the only enquiry which is to be made by the Commissioner would be about the objects of the trust or institution and the genuineness of its activities. The procedure for registration of the trust or institution is prescribed under Section 12AA. In terms of clause (a) of Section 12AA, the Commissioner is to satisfy himself about the genuineness of the activities and objects of the trust on such inquiries as he may deem necessary."
59. *Supra* note 38 at p.197
60. [2012] 51 SOT 175 (Cochin)(Trib.)
61. American Hotel & Lodging Association Educational Institute v. CBDT [2006] CTR (Delhi) 601
62. *Supra* note 38 at p.326
63. [2012] 21 taxmann.com 213 (Delhi)
64. Trustees of H.E.H. The Nizam's Pilgrimage Money Trust v CIT [2000] 243 ITR 676

outside India will not be a relevant factor during registration under Section 12AA of the Act. The tax authorities cannot, therefore, disallow registration on the pretext that a charitable organization holds property outside the tax territory of India.[65]

IV. Transfer of Funds When Made to a Foreign Territory

In the context of non-profit entity, transfer of funds can be made in two ways namely:

i. Transfer of funds when sent to an overseas branch or project
ii. Transfer of funds to organizations incorporated in a foreign territory

Entities that are incorporated in India but wish to have activities outside India as well will have to register under Section 10(23)(C), and then only can any transfer or contribution be made subject to provisions of FCRA. Similarly, no contributions by way of FCRA funds can be made by non-profit entities incorporated in India to a foreign charitable organization. For an organization to receive foreign contribution, it should be registered with the MHA under the said Act. Thus, for a non-profit entity (of foreign origin) to receive such contributions from an Indian entity, registration under the FCRA would be mandatory. FCRA registration of non-profit entities not incorporated in India is not envisaged under the Act. Non-profit entities in India are not permitted to transfer FCRA funds to other countries, nor can they have any direct activities outside India from FCRA funds.[66] However, there seems to be an exception for organizations registered under Section 10(23C)(vi) as they may have limited activities outside India as per FEMA regulations but even such entities cannot transfer FCRA funds to other charitable entities outside India. Therefore, FCRA funds under no circumstance can be transferred out of India, activities outside India (if any) have to be done from domestic income and application of such income to that effect must be duly incorporated in the trust deed.[67] A careful reading of Section 11 would indicate that no distinction is done based on the *situs* of incorporation of a charitable organization if the same is present and carries out charitable work in India. Section 11, therefore, does not make it mandatory, for all practical purposes, that trusts or voluntary organizations should be incorporated or registered in India. Even a foreign trust can have exemption provided its activities are in India and it is duly registered under Section 12A of the ITA. Furthermore, to claim exemption, it is also important that provisions of Section 10(22) are adhered to. The conditions are stated herein-below:

i. The educational institution must actually exist
ii. Some form of education should be imparted either in the form of primary or elementary education
iii. It should be engaged in educational purposes only and should be not for profit
iv. Only such income is entitled for exemption which is directly relatable to the educational activity.

Courts have rightly observed that a university established in a foreign country would come within the purview of Section 10(22) if its activities are for educational purposes.[68]

V. Non-Profit Entities Under Section 10(23)

Educational and medical institutions which are substantially funded by government under Section 10(23C)(iiiab) & (iiiac) and educational institutions under Section 10(23C)(iiiad) having a turnover less than Indian rupees 10 million are not required to apply for registration as their incomes are totally exempt without any conditions as laid down in Section 11(5). CBDT Circular No.1/2007, dated 27th April 2007, provides a time line as it becomes

65. M.K.Nambyar Saarc Law Charitable Trust v Union of India [2004] 140 Taxman 616 (Delhi)
66. *Supra* note 38 at p.332
67. *Ibid*
68. Educational Institute of American Hotel and Motel Association v CIT [1996] 219 ITR 183 (AAR)

necessary to expedite disposal of application made under Section 10(23C). A grant of registration or an order of rejection should, therefore, be passed within the period of twelve months from the end of the month in which such application was received. The Circular is, however, silent on a case where the delay exceeds 12 months. In such a situation an inference can be drawn from a recent judgment of Allahabad High Court in which it was held that if the Commissioner of Income-tax is unable to process the application made under Section 12AA within 6 months, then it will be deemed that the application for registration is granted. The reason stated by the High Court was that the intent of the statute was to frame a time-limit for disposal of such applications and, if deemed registration is not construed after the time lapse, then the very purpose of time limitation within the statute will get defeated and would run against the intent of the said provision. Hence, an application for registration made under Section 10(23C) will be deemed as registered if no action by the Commissioner of Income-tax is taken with regard to the application of registration or rejection thereof within twelve (12) months from the end of the month in which such application for registration was made.

In the case of an application under Section 10(23C) is rejected, the assessee may still be eligible under Section 11[69] provided the assessee had applied a return of income for claiming exemption under Section 10(23C) due to ignorance. The Assessing Officer is under a duty to ask for all information from the assessee at the time of scrutiny of documents, and failing to do so before completing the assessment under Section 143(3) will not render the 'revised return' *non est* for claiming exemption under Section 11 of the Act. Moreover, the CBDT Circular No. 14(XL-35)/1955, dated 11th April 1955 also states that the department should not take advantage of the ignorance of the assessee.[70] It must also be noted that once all requisite conditions under Section 11 have been met, even if conditions under Section 10(23C)(vi) have not been complied with, there will be no bar to seek exemption under Section 11.[71] Denial of registration under Section 10(23C)(iv) on grounds of misappropriation in the accounts books or excess expenditure on administrative costs etc., can only be upheld by the court when an order has been passed denying registration on such grounds after giving a proper hearing to the concerned party. Any order made in contravention of the said procedure will be bad in law.[72] Any withdrawal of exemption under Section 10(23C) made by the prescribed authority is non-appealable and the aggrieved party will have to prefer a writ petition under Article 226 of the Indian Constitution.[73]

In the case of *Nitya Education Society v Jt. CIT*[74], the Tribunal held that merely because an institution is in the process of establishing itself it would not make it ineligible for seeking registration under Section 10(23C)(iiiad) because of occurrence of the term 'existing' therein. Thus, if the object and intention of the organization is solely to establish an educational institution then approval under Section 10(23C) should not be denied; further, such approval should not be any assessment year specific.[75] The word 'existence' should be given a wider meaning and an institution should not be denied registration merely because it is in the process of establishing itself and is yet to be completely operational.[76]

VI. Voluntary Contributions and Other Incomes Under Section 12

As per Section 12(1) of the ITA, voluntary contributions are considered as a part of income

69. CIT v. Lucknow Public Educational Society [2009] 183 Taxman 62 (All.)
70. *Supra* note 38at p.354
71. CIT v. Mahasabha Gurukul Vidyapeeth Haryana [2010] 326 ITR 25 (Punj. & Har.)
72. Synodical Board of Health Services v. Director General of Income-tax [2012] 18 taxmann.com 133 (Delhi)
73. *Supra* note 38 at p.372
74. [2012] 51 SOT 103 (Delhi)(Tribunal)
75. O.P.Jindal Global University v. CCIT (Exemption) [2012] 22 Taxmann.com 118 (Punj. & Har.)
76. *Supra* note 39 at p. 371

for charitable organizations. For the purpose of Section 11 (1), voluntary contribution is considered as income except such contributions made with a specific purpose forming part of the corpus of the trust/institution. Although voluntary contributions are in the nature of receipts without consideration, it should be treated like a gift and not considered as income. Section 12(1) however treats it as deemed income for charitable organizations. The voluntary contributions have to be solely for charitable or religious purpose and even if only a small portion is for other purposes, the entire contributions would not be exempt. It may be noted that the flexibility of voluntary contribution under Section 12(1) does not imply forfeiture of income under various provisions of Section 13. Section 12(1) uses the word 'received' as against the word 'derived' in Section 11(1) (a). Therefore, voluntary organizations should always be treated as income on receipt basis only, irrespective of the method of accounting.[77]

VII. Wealth-Tax

As per Section 5(1) of the Wealth-tax Act, charitable organizations are exempted from paying wealth-tax in respect of the assets or property held under trust or other legal obligations for any public purpose of a charitable nature in India. Exemption under the wealth-tax may be withdrawn if the voluntary organization in question either forfeits or loses its exemption status under Section 12AA(3) of ITA. In case of forfeiture, for wealth-tax purposes, the voluntary organization will be treated as an individual assese.

VIII. Treatment of Donations

Donation is defined as "when a person, who is the owner of a thing, voluntarily transfers the title and possession of the same from himself to another, without any consideration is donation. A gift or gratuitous payment is, in simple English, a donation."[78] Thus, a donation is synonymous to gift minus consideration. Under ITA there are several avenues available for donations to claim deductions such as Section 37(1), Section 80G, Section 35AC and deductions under Section 35CCA, 80GGA etc.

The assessee making donations under Section 37(1) must establish a direct relation between the donation made and the running of the business of the assessee to claim deduction. A direct link needs to be established between contribution and trade of the assessee for the donation to fall within the ambit of business expenditure under Section 37(1). Thus, if the person making the donation is able to establish a direct nexus between the donation made and the usage of such donation for enhancement of business prospect of the assessee then such donation would be considered as deductible expenditure under Section 37(1).

Under Section 80G of the ITA, donors can also avail tax exemptions with deduction in the computation up to 100% of the donations made. To claim deduction under the present Section, donation must be made only in terms of money and not in kind. Any donation which is made in excess of Indian rupees ten thousand (INR. 10,000/-) must always be paid in any mode other than cash to claim deduction. If a donation is made cross-institutionally then the amount of such donation should be restricted to one-tenth of total gross income of the donor organization in order to claim deduction under sub-Section 4 of Section 80G.[79] Deduction is allowed only when the assessee has some income, and deduction is available only against taxable income. Unlike Section 37(1), the assessee is not required to prove a nexus between donation and business to claim deduction under the present Section.

An entity seeking exemption under Section 80G must apply for registration through Form 10G before the Commissioner of Income-tax/Director

77. *Ibid* at p. 470
78. *Ibid* at p. 936
79. *Ibid* at p. 944

of Income-tax (Exemption). Once the request for registration is made, the concerned authority should either grant the same or reject it within six (6) months from the date on which such application was made. This six month duration would not include the time taken by the assessee to furnish additional documents which the concerned authority may have called for during the course of six months for ascertaining the veracity of the documents presented along with the application. If the concerned authority, even after the expiry of six months from the date on which the application was made, does not grant permission or reject it then it would be deemed that application has been registered. All 80G certificates issued on or after the 1st of October, 2009 are permanent and perpetual in nature unless withdrawn by the department.[80] Similarly, organizations having income from business or profession are eligible to get 100% exemption under Section 35AC and, assessees not having income from business or profession, can claim deduction on donation made under Section 80GGA of the ITA.

80. CBDT Circular on Perpetual Nature of Sections 10(23C) & 80G Renewals, Circular No. 7/2010, dated October 27 2010

10. Not-For-Profit Entities in India

In India, charitable activities are carried out by three forms of entities namely trusts, societies and section 25[81] companies. All these entities get regulatory relaxations and fiscal interventions in the form of tax exemptions from the State in recognition of the fact that motive behind such operations are purely for charitable and public benefit purposes. Principles governing structural governance of non-profit entities across the globe are more or less the same. In India, ITA governs taxation issues of non-profit entities. Similarly, in US the Internal Revenue Code (IRS) governs the taxation issues of such entities.

Under the IRS, only two forms of voluntary organizations are recognized namely public charity and private foundation. The most common types of organizations that work in the field of non-profit sectors are charitable, educational and religious. Internal Revenue Code 501(c)(3) ("**Code**") provides that a corporation, community chest, fund or foundation may qualify for exemption if it organized and operated exclusively for charitable purposes.

I. Basic Framework for United States "Non-profits"

For a charitable organization to be tax-exempt under 501(c) Code, the entity must be organized and operated exclusively for the exempt purposes listed in 501(c)(3). 501(c)(3) states:

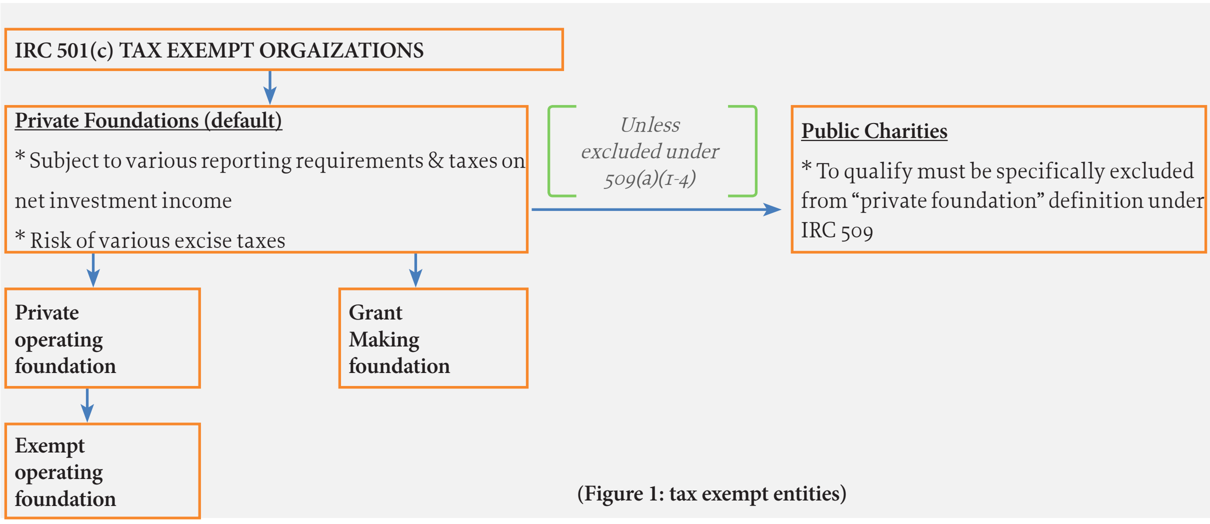
> *Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.*

An entity must be organized as a corporation, trust, or association for IRS to recognize the entity's exemption[83] however, a partnership will not be exempt. Most non-profits are organized in form of corporations, as formation of an association involves almost the same formalities as formation of a corporation, a corporation will provide a more certain legal structure, and in many jurisdictions, an un-incorporated association does not shield its members from liability.[84]

All organizations that qualify for tax exemption under 501(c) are designated private foundations unless specifically excluded from the definition under 509(a)(1-4).[85] In effect, IRC 509 divides non-profits into two separate and distinct classes: "private foundations" and "public charities".[86] The latter class is favorable for tax

81. Indian Companies Act, 1956 has been replaced by the Companies Act, 2013 and Section 8 in the new Act deals with not-for-profit companies.
82. 26 U.S.C. 501(c)(3)
83. IRS website, *Life Cycle of a Private Foundation – Starting Out*
84. 2E-2E:5 Lexis Tax Advisor – Federal Topic § 2E:5.03
85. A private foundation is also a charitable entity and described in the IRS by section 509. The IRS issues a 509(a) ruling to every organization with a 501(c)(3) tax-exempt ruling. Section 509(a) of IRS, which includes references to Section 170(b), is called both a public charity ruling and a private foundation ruling. While the 501(c)(3) ruling designates an organization's tax-exempt status, the 509(a) ruling further categorizes the organization as either a public charity or a private foundation. This designation is important to a potential grantor because it indicates whether the granting organization will be required to exercise expenditure responsibility for the organization's grant. *IRS website, Private Foundations*
86. Id.

purposes, since private foundations are subject to various reporting requirements and taxes on net investment income.[87] Unlike public charities, private foundations risk various excise taxes.[88] Under 509(a)(1-4), organizations considered public charities rather than private foundations (the default designation) include churches, educational organizations which maintain regular faculty and regular curriculum, hospitals or medical research facilities, and organizations which test for public safety. Further, public charities include organizations which have an active program of fundraising and receive contributions from many sources, including the general public, government agencies, corporations, private foundations or other public charities, or receive income from the conduct of activities in furtherance of the organization's exempt purposes or actively function in a supporting relationship to one or more existing public charities.[89] For such organizations to be considered public charities the aggregate of contributions should exceeds 50% of a taxpayer's contribution base for the taxable year.[90]



(Figure 1: tax exempt entities)

Generally, public charities draw their support from a variety of sources, while private foundations typically "have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources) and most have as their primary activity the making of grants to other charitable organizations and to individuals, rather than the direct operation of charitable programs."[91] If an organization is appropriately designated a private foundation, it is further classified as either a private operating foundation, an exempt operating foundation, or a grant-making foundation. The private operating foundations are those which contribute the majority of their resources to the active conduct of exempt activities. Such foundations are subject to the same restrictions and risks as other forms of private foundations (including the tax on net investment income), except that private operating foundations are not subject to an excise tax for failure to distribute income.[92]

Further, contributions to private operating foundations described in Code section 4942(j)(3) are deductible by the donors to the extent of 50 percent of the donor's adjusted gross income, whereas contributions to all other

87. Id.
88. Id.
89. IRS website, *Public Charities*
90. 26 U.S.C. § 170(b)(1)(A)(viii).
91. IRS.gov, *Life Cycle of a Public Charity/Private Foundation*
92. 26 U.S.C. § 4942(j)(3).

private foundations are generally limited to 30 percent of the donor's adjusted gross income."[93] A private operating foundation is only classified as an exempt operating foundation—and thus not subject to the tax on net investment income subject to the condition that (i) it has been publicly supported for 10 years; (ii) governing body consists of individuals less than 25 percent of whom are disqualified individuals and is broadly representative of the general public; and (iii) has no officer who is a disqualified individual during the year.[94] In case private foundations that do not qualify as private operating foundations, they are generally referred to as grant-making foundations or private non-operating foundations.[95]

II. United States Regulation of International Non-profit Entities

A United States non-profit may conduct all or part of its charitable activities in a foreign country without jeopardizing its tax-exempt status[96] (subject to the laws and regulations of the country of origin). Further, an organization's tax-exempt status will remain unchanged even if it distributes funds to individuals or other organizations that are not charities, so long as the distribution is charitable and aimed at achieving the organization's purpose.[97]

Interestingly, the U.S. government does not interfere with how the non-profit entity accomplishes its purposes. Charitable entities are free to recruit participants for their organizations as they wish, and need not provide notification to any government agency about its membership, activities, or outreach. Like other U.S. organizations and companies, U.S. non-profit entities must refrain from working with governments or individuals under U.S. sanctions, as well as with groups designated as foreign terrorist organizations, but otherwise, they are free to collaborate with foreign NGOs or foreign governments to achieve their purposes. There are no regulations that restrict U.S. non-profit entities from attending conferences abroad, finding donors overseas, or performing work internationally.[98]

Accordingly, United States non-profits may significant flexibility in conducting affairs abroad without foregoing tax-exemption. Contributions to such non-profits are only deductible; however, if the contribution is in fact to or for the use of the domestic organization and the domestic organization is not serving as an agent for, or conduit of, a foreign charitable organization.[99]

501(c)(3) Entities Operating in India and Entitlement to Treaty Benefits

Taxation of income in India is governed by the provision of ITA. The ITA contains separate rules for the taxation of residents and non-residents. Residents are taxable on worldwide income, while non-residents are taxable only on Indian-source income (i.e. only and to the extent that such income accrues or arises, or is deemed to accrue or arise in India or is received or deemed received in India).

Such taxability of non-residents on their Indian-source income is however subject to the provisions of the applicable tax treaty to the extent they are more beneficial to the non-resident. In addition to the conditions prescribed under the relevant tax treaty regarding the applicability of such tax treaty, the ITA prescribes certain additional conditions for availing the benefit of a

93. IRS.gov, *Private Operating Foundations*
94. IRS.gov, *Exempt Operating Foundations*
95. IRS.gov, *Grant Operating Foundations*
96. IRS Memorandum (hereinafter "IRS Memo"), Office of Chief Counsel, 200504031 at p. 2 (28/01/2005) (citing Rev. Rul. 63-252, 1963-2 C.B. 101).
97. Id.
98. Fact Sheet: Non-Governmental Organizations (NGOs) in the United States, U.S. Dept. of State, *http://www.humanrights.gov/2012/01/12/fact-sheet-non-governmental-organizations-ngos-in-the-united-states/*
99. IRS Memo, p.2.

tax treaty entered into by India.[100]

The foremost requirement for the applicability of the India-US tax treaty ("**Treaty**") to a charitable organization which is a tax exempt entity under the Code, is that it should qualify as a person as defined in the Treaty. Article 3.1(e) and 3.1(f) of the Treaty provides that the term *"person" includes an individual, an estate, a trust, a partnership, a company, any other body of persons, or other taxable entity and the term "company" means, any body corporate or any entity which is treated as a company or body corporate for tax purposes respectively.*

If the charitable organization does not qualify as either of the specific entities (particularly trust, company, any other body of persons), it is important to analyze the meaning of the terms 'taxable entity'. The term should not mean an entity actually taxed, but an entity that may be 'liable' to tax under the relevant domestic regime. To the extent that the tax free status of charitable organization is derived from a specific exemption provision pursuant to a 501(c)(3) registration, we can assume that the charitable organization would otherwise have been considered a taxable entity in the United States. However, this position has not been free of doubt and there have been judicial views expressed to the contrary. But, the position would not be relevant if the charitable organization qualifies as either of the specific entities (particularly trust, company, any other body of persons), in which case it should qualify as a 'person' irrespective of its tax-exempt status.

The next requirement for availing the benefit of the Treaty is that the charitable organization should be a resident of the US as defined in Article 4.1 of the Treaty.[101] In this context, the nature of the entity the charitable organization is set up as – body corporate, trust, foundation, etc. If the charitable organization is established as an entity (for example, a body corporate) which is not one of the entities referred to in Article 4.1(b) above (particularly a trust), to qualify as a resident of the US for the purposes of the Treaty, it would have to satisfy only one test – it should be 'liable' to tax in the US in the manner outlined above – i.e., by reason of domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature. Also, as already highlighted above, it should possess a tax residency certificate issued by the US government with respect to the period for which it proposes to claim Treaty relief.

However, if it is established as either of the entities referred to in Article 4.1(b), it will also have to satisfy the additional test of being actually subject to tax in the US. Therefore, given that its income is exempt from tax under Section 501 of the IRC, to satisfy the condition, its income should be subject to tax in the hands of its beneficiaries.

III. Concluding Comments

The Code status entails strict regulatory requirements and adherence to IRS Regulation. In addition, state-wise compliances are also required to be followed. Non-filing of paper work or mis-stating the records of funds may jeopardize the tax-exempt status. Moreover, all due care must be taken to ensure that no lobby is conducted in the name of charity and activities arising out of

100. The non-resident should obtain a tax residency certificate ("**TRC**") from the government of which he is a resident pertaining to the relevant period; the non-resident should furnish certain prescribed particulars to the extent they are not contained in the TRC; the non-resident should obtain a tax id in India (called the permanent account number); and the non-resident should file tax returns in India.

101. Article 4.1 of the Treaty reads:
For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, provided, however, that
(a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and
(b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries.

such charitable work does not benefit any private citizen. To avail of the tax-exemptions, growing number of new ventures have elected to be non-profit organizations. Many of these ventures depend on federal tax exemption to scale-up their business and conduct charitable work at the same time. 501(c)(3) provision, besides being used for charitable activities, can also be used by entities to gain new forms of capitalization and business plans.

10. Conclusion

The social sector industry in India has grown manifold. New forms of business have emerged and with it new and young breeds of entrepreneurs have come to the fore-front. These young leaders will provide several social and technological solutions to many of India's social sector problems in the coming days and years. At the same time, one also needs to look into the administrative and professional side of carrying out charitable activities in India. Companies, organizations and individuals have become more structured and professional in their approach to philanthropy and charitable activities. Gone are the days when doling out cheques was considered philanthropic and charitable. In today's world, charity has become more strategically linked to a company's balance sheets and visibility. Legal and market reforms in the last two decades have enabled private players to participate in national building through charitable activities with much vigor. While tax implications are clear and well explained in ITA, a need for greater clarity is required under the Companies Act, and the Regulations thereunder with regard to investment and expenditure of CSR funds for charitable purposes.

The recent CSR provision in the Companies Act has the potential to usher a new era in the field of corporate and institutional philanthropy in India. The challenges faced by the philanthropy sector, however, remain manifold. Social business as a concept has found strong footholds in India. The time is ripe to take social business to the next level and CSR can provide the crowding-in effect for such business. Corporates and not-for-profit entities must engage more and participate regularly with civil society organizations so that capacity building at the grass-root level is strengthened. In the absence of democratization and decentralization at the lowest level, the trickle-down-effect that Prahalad's model proposed may be difficult to achieve.

Central and State legislations regulating non-profit sector need to be more open and accommodating of genuine demands made by the donors. Under the existing laws it is almost impossible for foreign donors to have any direct administrative control or direct say in the functioning of the recipient organization. In such a situation it becomes difficult for such donors to ensure transparency and accountability of their funds. Owing to a very wide ambit of FCRA, genuine foreign contributors or donors often face a lot of legal and regulatory compliances to adhere (to), which eventually leads to donations either getting denied or unduly delayed to reach the intended beneficiaries.

The definition of terms like 'education', 'relief of the poor' etc. needs to be expanded under the ITA. Judicial pronouncements on the above terms have proved to be very restrictive and counter-productive. Fiscal laws and regulations need to be more accommodating to the demands of social sector. Governance issues should be given due importance as compliances can go a long way in ensuring corporate governance of donor companies. At the same time, non-profit organizations should also consider engaging with market players with a renewed vigor and not just looking at the arrangement from a donor-recipient perspective. Successful social business models can only be created and replicated when such organizations are more professional, transparent and wish to scale up.

The recently passed Companies Act may prove to be a game-changer for corporate and institutional philanthropy. Although more clarity is required with respect to CSR Rules and other compliance requirements, corporate India has come a long way from being a corporate citizen to becoming a responsible corporate citizen. With the rise of globalization and de-regulated market, we may begin to see many Indian companies setting up non-profit entities in the US as well. Companies across jurisdictions are looking to enter into new forms of market, develop new models of social businesses and practice innovative models of corporate governance aimed at optimizing social returns on such investments.

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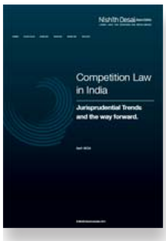

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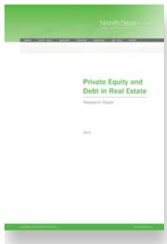

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