India: Great Potential and Promise

by Milton Cerny and Marva J. Rowan

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Goldman Sachs in a recent report predicted that India would be the world's third largest economy by the year 2050, behind the the United States and China, surpassing the United Kingdom in 20 years and Japan in 30 years. India, with its population of more than 1.05 billion people, is a land of many contrasts. Economically, the country is unrecognizable from a decade ago. This year's economic forecast calls for an impressive 7 percent rate of growth, nearly double that of 2002. This growth has been generated basically in New Delhi where automobile manufacturing and particularly information technology have fueled economic growth. Google, the world's largest Internet search engine, and IBM, are transferring their highest paying programming functions offshore to India.

However, the bright economic news does not hide the problems that India faces in bringing prosperity to its poorest states. India's masses are held back, hindered in large part by a political system controlled by caste and religion and an agrarian economy that has locked millions of Indians into poverty. A recent report issued by the United Nations shows that almost half of India's children remain chronically malnourished and that the country's literacy rate is below 65 percent.

The good news is that democracy is alive and well because of the independent institutions of a free press, judiciary, and the thousands of nonprofit organizations (NPOs) that operate there. Thus, the NPO sector has a great potential for growth and development because of India's global economy and the 20 million nonresident Indians are being lured back to India, bringing with them the entrepreneurial technology and financial resources they have gained in the West. Access to these funds, the generational transfer of wealth, and the experiences gained in the West will fuel the future growth and sustainability of the NPO sector.

I. Introduction

Volunteerism has always been a part of Indian culture and social tradition. The roots of the nonprofit sector can be traced back to the tenets of the various religions that have dominated India, such as Hinduism and Islam, which enjoin individuals to help the needy.

At the beginning of the 19th century, Christian missionaries in India began to engage in organized efforts aimed at social reform and empowerment and were soon joined in their efforts by the Indian elite. In particular, these social reformers began to establish schools, hospitals, and agricultural colonies with a view toward bettering the socioeconomic conditions of the Indian people. They also fought against the inferior treatment of women and the caste system.

During the late 19th and early 20th centuries, Indian nonprofit organizations were influenced by the freedom movement and became increasingly nationalistic in their goals. The voluntary sector gained increasing momentum in the 1920s and 1930s from Gandhi, who promoted voluntary action as the only path to India's development and independence. After India obtained independence in 1947, the number of nonprofit organizations surged. According to one estimate, the increase of the number of organizations from 1953 to 1980 was fivefold. Many organizations in the post-independence period, influenced by Gandhian ideals, engaged in nation-building and development-related activities, while others focused on relief work for refugees and flood and famine victims.[1]

Since that time, both the nature of activities engaged in by nonprofits and the characteristics of those establishing nonprofits have become increasingly varied, although there is still a strong emphasis on development and community empowerment. Throughout this time, the government has, through various tax benefits, promoted the work being done by nonprofit organizations, while maintaining sufficient regulatory mechanisms to prevent abuse. The nature of these tax benefits and their related requirements are discussed

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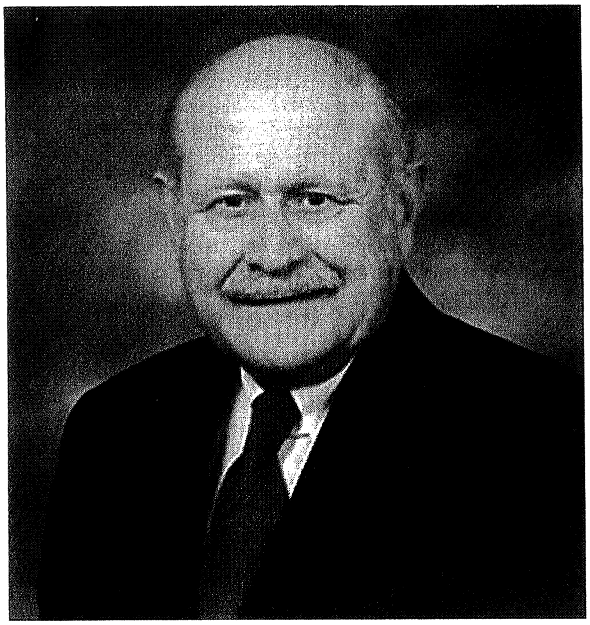
[1] *See generally*, Asia Pacific Philanthropy Consortium, *Strengthening Philanthropy in the Asia Pacific: An Agenda for Action*, Background Paper: India (Sept. 2001); *Siddhartha Sen, Defining the Nonprofit Sector: India*, Working Papers of the Johns Hopkins Comparative Nonprofit Sector Project, no. 12 (L.M. Salamon and H.K. Anheier eds., The Johns Hopkins Institute for Policy Studies) (1993); R. Sooryamoorthy and K.D. Gangrade, *NGOs in India: A Cross-Sectional Study* 39-53 (Greenwood Press 2001).



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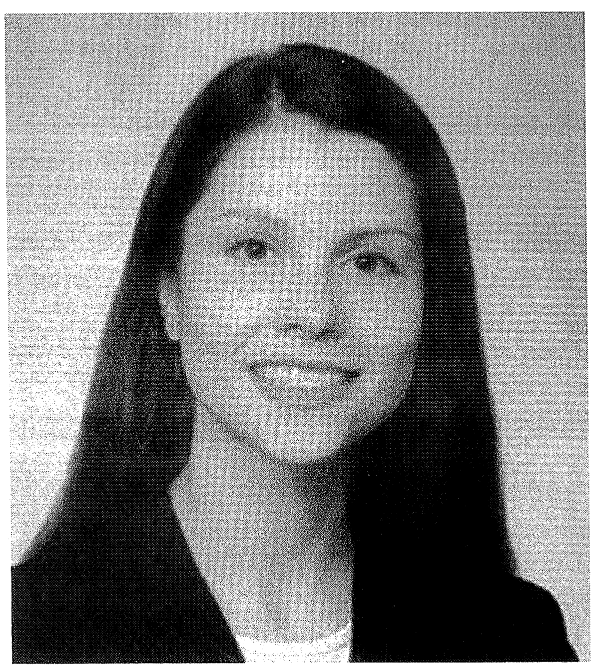

Marva J. Rowan

below. As there are many U.S. citizens and residents of Indian origin who may wish to contribute to Indian charities, there is also an examination of the U.S. tax laws applicable to charitable contributions to foreign organizations.

II. Legal Form of NPOs

There are various legal forms that an NPO in India may take. Generally, Indian NPOs take the form of a society registered under the Societies Registration Act, 1860, a trust registered under the Indian Trust Act, 1882, or a company registered under section 25 of the Companies Act, 1956.

A. Societies

The Societies Registration Act, 1860 provides that "[a]ny seven or more persons associated for any literary, scientific, or charitable purpose, or for any such purpose as is described in section 20 of this Act" may become a society by filing a memorandum of association with the Registrar of Joint-Stock Companies.[2] The specific purposes enumerated in section 20 of the Societies Act are: charitable societies; the military orphan funds or societies established under the several presidencies of India; societies established for the promotion of science, literature, or the fine arts; for instruction, the diffusion of useful knowledge, the diffusion of political education, the foundation or maintenance of libraries or reading rooms for general use among the members or open to the public; or public museums and galleries of paintings and other works of art; and collections of natural history, mechanical and philosophical inventions, instruments, or designs.

B. Trusts

There are two types of trusts in India: public and private. Although there is no law governing the formation of public trusts, such trusts may be registered under the Registration Act, 1908.[3] A private trust is created under the Indian Trusts Act, 1882.[4] Under the Indian Trusts Act, 1882, a trust may be created for any lawful purpose by any person who is competent to contract.[5] A trust is created by any words or acts that

[2]Societies Registration Act, 1860 §1. The memorandum of association filed with the Registrar must contain the name of the society, the purposes of the society, and the names, addresses, and occupations of the members of the governing body of the society. A copy of the rules and regulations of the society also must be filed with the memorandum of association and must be certified as a correct copy by at least three members of the governing body. *See* Societies Registration Act, 1860 §2.

[3]Siddhartha Sen, *Defining the Nonprofit Sector: India*, at 19.

[4]*Id.*

[5]Indian Trusts Act, 1882 §§4, 7. Section 4 provides that the purpose of a trust is lawful unless it is (a) forbidden by law, or (b) is of such a nature that, if permitted, it would defeat the provisions of any law, or (c) is fraudulent, or (d) involves or implies injury to the person or property of another, or (e) the court regards it as immoral or opposed to public policy.

indicate with reasonable certainty the intention to create a trust, the purpose of the trust, the beneficiary of the trust, and the property of the trust.

C. Companies

The Companies Act, 1956 generally provides for the creation and registration of companies in India. Under section 25, the Central Government may grant an association a license to be registered as a company with limited liability if (i) the company's purpose is to promote commerce, art, science, religion, charity, or any other useful object, and (b) it intends to apply any income and profits in promoting its objects, and it prohibits the payment of any dividend to its members.

III. Tax Exemptions for NPOs

The Income Tax Act, 1961 provides automatic income tax exemptions for certain specified categories of organizations. NPOs that do not fall within those specific categories may obtain an exemption from the income tax if they register with the Commissioner of Income Tax and meet certain statutory requirements.

A. Organizations With Automatic Exemption

The income of the following organizations, *inter alia*, is automatically tax-exempt, provided that the organizations apply or accumulate their income for the purposes for which they are established:

(i) any income (including voluntary contributions) of a scientific research association;[6]

(ii) certain income of an institution established in India whose purpose is the control, supervision, regulation, or encouragement of the profession of law, medicine, accountancy, engineering, or architecture;[7]

(iii) any income of an institution constituted as a public charitable trust or registered under the Societies Registration Act, 1860 whose sole purpose is to promote the development of *khadi* or village industries or both, and not for purposes of profit, to the extent such income is attributable to the business of production, sale, or marketing, of *khadi* or products of village industries;[8]

(iv) universities and other educational institutions existing solely for educational purposes and not for purposes of profit; and

(v) hospitals and other medical institutions established for philanthropic purposes and not for profit.[9]

B. Entities That May Obtain Exemption by Registration

Charitable or religious organizations that are not specifically designated in section 10 as exempt from income tax may, nevertheless, obtain such exemption by fulfilling certain conditions and registering with the Commissioner.

1. Requirements for Exemption. The Income Tax Act, 1961 provides that income from property held under trust for charitable or religious purposes is not subject to income tax to the extent that the income is applied during the year for such purposes in India.[10] Section 2(15) of the Act defines "charitable purpose" as "relief of the poor, education, medical relief, and the advancement of any other object of general public utility."[11] Voluntary contributions received by a trust or institution are deemed to be income from property held under trust for these purposes and, therefore, are exempt as long as the other requirements have been met.[12]

In addition, up to 15 percent of the income may be accumulated or set apart without the imposition of income tax.[13] Any income in excess of 15 percent may be accumulated or set apart for up to five years, provided that the following conditions are satisfied:

(i) The entity must give written notice to the Assessing Officer specifying the purpose for which the income is being accumulated or set apart and the period for which the income is to be accumulated (but no longer than five years); and

(ii) The money accumulated or set apart must be invested in the certain specified investments (which do not include shares in private companies).[14]

This accumulated income will be subject to tax any time in the future if it (a) is applied for purposes other than those for which it was set apart, (b) ceases to be

[6]Income Tax Act, 1961 §21.

[7]Income Tax Act, 1961 §23A.

[8]Income Tax Act, 1961 §23B.

[9]Income Tax Act, 1961 §23C.

[10]Income Tax Act, 1961 §11(1)(a). Section 11(1) also provides an exemption (i) for income held in trust where the trust is only partly for charitable or religious purposes if the trust was created before the commencement of the Income Tax Act, and (ii) for income from property held under trust for a charitable purpose that is applied outside of India if it promotes international welfare in which India is interested. *See* §§11(1)(b)-(c).

[11]Previously, section 2(15) specified that a charitable purpose must not involve the carrying on of any activity for profit. This requirement, however, was deleted by the Finance Act, 1983, effective as of April 1, 1984.

[12]Income Tax Act, 1961 §§11(1)(d), 12.

[13]Income Tax Act, 1961 §11(1)(a), as amended by the Finance Act, 2002. The Income Tax Act originally provided that up to 25 percent of income could be accumulated tax-free. However, the Finance Act 2002 reduced the accumulation limit to 15 percent, effective April 1, 2003.

[14]Income Tax Act, 1961 §11(2). The Income Tax Act originally provided that such income could be accumulated for up to 10 years. However, the Finance Act 2002 reduced the accumulation period to five years, effective April 1, 2003.

invested in the specified forms, (c) is not utilized before the expiration of the five-year period, or (d) is paid to another NPO.[15] (Note that while *accumulated* income distributed to another NPO will not be considered to be applied for charitable or religious purposes, no similar limitation exists for non-accumulated income, i.e., income paid to another NPO will count toward the 85-percent distribution requirement for a year.)

Where a capital asset held in a charitable or religious trust is sold or exchanged, the consideration received will be treated as being applied for charitable or religious purposes to the extent that such consideration is used to acquire another capital asset to be held in the trust.[16]

Any business profits or gains received by the trust or institution will be exempt from income tax if (i) the business is incidental to attaining the purposes of the trust or institution, and (ii) separate books are maintained with respect to the business.[17]

In addition to the foregoing, the following conditions must be satisfied for any income of the trust or institution to be exempt from tax:

(i) No part of the income may inure, directly or indirectly, for the benefit of: the creator of the trust or founder of the institution, any person whose aggregate contributions to the trust or institution exceed 50,000 rupees, any trustee of the trust or manager of the institution, any relative of any of the foregoing persons, or any concern in which any of the foregoing persons have a substantial interest (subject to certain exceptions for trusts and institutions created before the effective date of the Income Tax Act);

(ii) The funds of the trust or institution must be invested in certain specified investments, which do not include shares in private companies;

(iii) The trust or institution may not be created for the benefit of a particular religious community or caste; and

(iv) The trust may not be for private religious purposes unless the income inures for the benefit of the public.[18]

2. Registration. The income of a charitable or religious trust or institution will be exempt from income tax in accordance with the above provisions only if it has registered with the Commissioner of Income Tax. The exemption will apply from the date of the trust or institution's creation if registration is applied for within one year from the date of creation or, if not applied for within the designated period, if the failure is due to reasonable cause.[19] Otherwise, the income exclusion will apply from the first day of the financial year in which the application is made.[20]

The Commissioner must issue an order granting or refusing the application for registration within six months of the receipt of the application.[21] In making such a decision regarding registration, the Commissioner may request any documents or other information from the trust or institution and may make any inquiries that he believes are necessary for him to make his decision. If he is satisfied with the purposes of the trust or institution and the genuineness of its activities, the Commissioner will issue a written order registering the trust or institution. If the Commissioner is not satisfied with the purposes and activities of the trust or institution, he must give the applicant an opportunity to be heard. If he is still not satisfied, he will issue an order in writing refusing to register the trust or institution, and a copy of the order will be sent to the applicant.[22]

IV. Income Tax Deduction for Donors

A donor, whether an individual, company, or other entity, is allowed to take a deduction against his gross total income for donations to those organizations named in or registered under section 80G of the Income Tax Act (subject to the limitations described below), or named in sections 80GGA, 35, 35AC, 35CCA, or 35CCB.[23] The donations must have been made in cash; no deductions are allowed for in-kind donations of property.

A. Deductions Under Section 80G

1. Organizations Registered Under Section 12AA. Donations to trusts and institutions registered under section 12AA (which form the bulk of NPOs in India) must obtain a certificate of registration from the tax authorities under section 80G for donations to be tax-deductible by donors. To obtain a certificate of registration under section 80G, NPOs must meet the following conditions:

(i) The institution must be a public charitable trust, a society registered under the Societies Registration Act, a company registered under section 25 of the Companies Act, or a university or other educational institution established by law or recognized by the government;

[15]Income Tax Act, 1961 §§11(3)(a)-(d), as amended by the Finance Act, 2002. Before the Finance Act amendments, there was no restriction related to paying accumulated income to another charitable or religious trust or institution.

[16]Income Tax Act, 1961 §11(1A).

[17]Income Tax Act, 1961 §11(4A).

[18]Income Tax Act, 1961 §§13(1)(a)-(d).

[19]Income Tax Act, 1961 §12A(a). Application for registration is made on Form No. 10A.

[20]Income Tax Act, 1961 §12A(a)(ii).

[21]Income Tax Act, 1961 §12AA(2).

[22]Income Tax Act, 1961 §12AA(1).

[23]Income Tax Act, 1961 §80G(1).

(ii) The institution's governing instrument may not permit any income or assets to be used for a noncharitable purpose;

(iii) The institution may not be for the benefit of a particular religious community or caste; and

(iv) The institution must maintain regular accounts for its receipts and expenditures.[24]

Donations to these registered organizations are limited to 10 percent of the donor's gross total income. Any donations above 10 percent of the donor's gross total income may not be deducted.[25] Furthermore, only 50 percent of the allowable amount may be deducted from income.[26]

2. Other Organizations. Donations to the other funds and organizations listed in section 80G are automatically tax-deductible by donors; no registration is required. Moreover, with a few exceptions, donations to these funds and organizations generally are not subject to the 10-percent income limit. Deductions are allowed for either 50 percent or 100 percent of the donated amount, depending on the particular organization.[27]

B. Deductions Under Section 80G, 35, 35AC, 35CCA, and 35CCB

Deductions for donors are also available under section 80GGA for donations to the following organizations for the following purposes, provided that the organization has been approved by the relevant authority:

(i) A scientific research association;

(ii) A university, college, or other institution to be used for scientific research, social science research, or statistical research;

(iii) An institution undertaking a rural development program or training persons for rural development programs;

(iv) A public sector company, local authority, or institution for carrying out projects promoting the social and economic welfare of the public;

(v) An institution undertaking a program of natural resource conservation or afforestation;

(vi) A rural development fund; and

(vii) The National Urban Poverty Eradication Fund.[28]

The deductions under section 80GGA are technically allowed only for donors who have no income in the category of "profits and gains of business or profession."[29] For those donors with business income, similar deductions are allowed under sections 35, 35AC, 35CCA, and 35CCB. Donations under 80GGA, 35, 35AC, 35CCA, and 35CCB are fully deductible. They are subject to neither the 10-percent gross total income limit nor the 50-percent deduction amount imposed under section 80G.

V. Requirements for NPOs Receiving Foreign Funds

Any organization receiving funds from any foreign source must (i) register with the Ministry of Home Affairs under the Foreign Contribution (Regulation) Act, 1976, and (ii) receive such contributions through an Indian bank.[30] Foreign sources include, *inter alia*, a citizen of a foreign country, a foreign trust or foundation, and a society or other association of individuals formed or registered outside of India.[31] Any Indian organization that is not registered to receive foreign contributions must obtain specific permission before accepting any foreign contribution.[32] In either case, the Indian organization is required to notify the government of the source and amount of the foreign contribution(s) received by it, the manner of receipt, and the purposes for which and manner in which such foreign contribution was used by the organization.[33] It is also required to maintain an account of foreign contributions received and a record of the manner in which the contribution was used.[34]

If an organization does not comply with this Act, as adjudicated by a court, the government may confiscate the funds improperly received.[35] In addition, monetary fines and prison sentences up to five years may be imposed.[36]

VI. U.S. Tax Considerations for Citizens and Residents

No U.S. income tax deduction will be allowed for contributions made to Indian charities, as a charitable deduction for U.S. income tax purposes is allowed only for contributions made to U.S. charities or for use within the United States.[37] Of course, if a U.S. taxpayer has India-source income, contributions to an Indian charitable organization could be deducted from Indian

[24]Income Tax Act, 1961 §80G(5).

[25]Income Tax Act, 1961 §80G(4).

[26]Income Tax Act, 1961 §80G(1)(ii).

[27]Income Tax Act, 1961 §§80G(1)(i), 80G(2).

[28]Income Tax Act, 1961 §80GGA.

[29]Income Tax Act, 1961 §80GGA(3).

[30]Foreign Contribution (Regulation) Act, 1976 §6(1).

[31]Foreign Contribution (Regulation) Act, 1976 §2(e).

[32]Foreign Contribution (Regulation) Act, 1976 §6(1A).

[33]Foreign Contribution (Regulation) Act, 1976 §§6(1)-(1A).

[34]Foreign Contribution (Regulation) Act, 1976 §13.

[35]Foreign Contribution (Regulation) Act, 1976 §18.

[36]Foreign Contribution (Regulation) Act, 1976 §§23-25.

[37]IRC §170(c)(2). While there are ways in which a U.S. taxpayer can ultimately benefit Indian charitable causes while qualifying for a U.S. income tax charitable deduction (*e.g.*, by making gifts to U.S. charities with operations in India, to U.S. "Friends" organizations, or to U.S. private foundations that make grants to support charitable activities in India), these methods are beyond the scope of this article.

income, provided that the organization meets the requirements described above.

Unlike the income tax deduction, the estate and gift tax charitable deduction for U.S. citizens and residents is not limited to bequests or gifts to U.S. organizations. Therefore, a U.S. citizen or resident may obtain an estate or gift tax charitable deduction for contributions to Indian charities, provided the organization is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, and no part of its net earnings inures to the benefit of a private individual or for political activities.[38] U.S. nonresidents, however, do not enjoy similar treatment. A nonresident is allowed a U.S. charitable deduction for bequests or gifts only if made to a U.S. charity or for use within the United States.[39]

Because of the restrictions imposed by India's Foreign Contribution (Regulation) Act, any U.S. citizen contemplating a gift or bequest to an Indian nonprofit organization should determine whether the organization is registered under the Act and, consequently, will be able to accept the contribution. In the case of a bequest, a testator should provide for alternate charitable devisees in the event the intended organization is not registered under the Foreign Contributions (Regulation) Act at the time the bequest is to be paid or cannot otherwise obtain permission to receive the bequest.

V. Conclusion

A new era has indeed arrived in India not only in terms of economic development, but also in terms of political leadership, as India attempts to settle long festering disputes with its neighbor Pakistan, which have existed since 1947 when the nations were divided into two separate nations following British rule. India again is ready to take on the mantle of leadership that it carried as the leader of the unaligned nations in the geopolitical chasm that existed between the nations aligned with the United States and those aligned with Russia. Today we live in a different world but the same threats to humanity still exist in the form of nuclear arsenals, terrorism, and unstable governments. India through its developing civil society can play a major role in Southeast Asia to help alleviate these threats by bringing stability, democracy, and economic progress to the peaceful resolution of these issues. The nonprofit sector will continue to shape that civil society and encourage peaceful resolution of issues that have divided not only India but the whole of Southeast Asia. Our lives will be greatly influenced by the emergence of China and India as world powers; it is hoped that this emergence will come in the spirit of Mahatma Gandhi.

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[38]IRC §2055(a), 2522(a); Treas. reg. §§20.2055-1(a), 25.2522(a)-1(a).

[39]IRC §§2106(a)(2), 2522(b); Treas. reg. §§20.2106-1(a)(2), 25.2522(b)-1(a).