Social Sector Audit Paper

Time for Evaluation: Insight into Legal, Regulatory and Tax Framework for not-for-profit Entities

January 2017

About NDA

Nishith Desai Associates (NDA) is a research based international law firm with offices in Mumbai, Bangalore, Silicon Valley, Singapore, New Delhi & Munich. We specialize in strategic legal, regulatory and tax advice coupled with industry expertise in an integrated manner. We focus on niche areas in which we provide significant value and are invariably involved in select highly complex, innovative transactions. Our key clients include marquee repeat Fortune 500 clientele.

Our practice areas include International Tax, International Tax Litigation, Litigation & Dispute Resolution, Fund Formation, Fund Investments, Corporate & Securities Law, Mergers & Acquisitions, Competition Law, JVs & Restructuring, Capital Markets, Employment and HR, Intellectual Property, International Commercial Law and Private Client. Our specialized industry niches include funds, financial services, IT and telecom, pharma and healthcare, media and entertainment, real estate and infrastructure & education.

Nishith Desai Associates has been ranked as the Most Innovative Indian Law Firm (2014 & 2015) at the Innovative Lawyers Asia-Pacific Awards by the Financial Times - RSG Consulting. Nishith Desai Associates has been awarded for “Best Dispute Management lawyer”, “Best Use of Innovation and Technology in a law firm”, “Best Dispute Management Firm”, and “M&A Deal of the year” by IDEX Legal 2015 in association with three legal charities; IDIA, iProbono and Thomson Reuters Foundation. Nishith Desai Associates has been recognized as a Recommended Tax Firm in India by World Tax 2015 (International Tax Review’s directory). IBLJ (India Business Law Journal) has awarded Nishith Desai Associates for Private equity & venture capital, structured finance & securitization, TMT and Taxation in (2014/2015). IFLR1000 has ranked Nishith Desai Associates in Tier 1 for Private Equity (2014). Chambers and Partners ranked us as # 1 for Tax and Technology-Media-Telecom (2014/2015). Legal 500 ranked us in # 1 for Investment Funds, Tax and Technology-Media-Telecom (TMT) practices (2011/2012/2013/2014). IDEX Legal has recognized Nishith Desai as the Managing Partner of the Year (2014).

Legal Era, a prestigious Legal Media Group has recognized Nishith Desai Associates as the Best Tax Law Firm of the Year (2013). Chambers & Partners has ranked us as # 1 for Tax, TMT and Private Equity (2013). For the third consecutive year.

International Financial Law Review (a Euromoney publication) has recognized us as the Indian “Firm of the Year” (2012) for our Technology - Media - Telecom (TMT) practice. We have been named an Asian-Mena Counsel ‘In-House Community Firm of the Year’ in India for Life Sciences practice (2012) and also for International Arbitration (2011). We have received honorable mentions in Asian Mena Counsel Magazine for Alternative Investment Funds, Antitrust/Competition, Corporate and M&A, TMT and being Most Responsive Domestic Firm (2012).

We have been ranked as the best performing Indian law firm of the year by the RSG India Consulting in its client satisfaction report (2011). Chambers & Partners has ranked us # 1 for Tax, TMT and Real Estate – FDI (2011). We’ve received honorable mentions in Asian Mena Counsel Magazine for Alternative Investment Funds, International Arbitration, Real Estate and Taxation for the year 2010.

We have been adjudged the winner of the Indian Law Firm of the Year 2010 for TMT by IFLR. We have won the prestigious “Asian-Counsel’s Socially Responsible Deals of the Year 2009” by Pacific Business Press.

In addition to being Asian-Counsel Firm of the Year 2009 for the practice areas of Private Equity and Taxation in India. Indian Business Law Journal listed our Tax, PE & VC and Technology-Media-Telecom (TMT) practices in the India Law Firm Awards 2009. Legal 500 (Asia-Pacific) has also ranked us #1 in these practices for 2009-2010. We have been ranked the highest for ‘Quality’ in the Financial Times – RSG Consulting ranking of Indian law firms in 2009. The Tax Directors Handbook, 2009 lauded us for our constant and innovative out-of-the-box ideas. Other past recognitions include being named the Indian Law Firm of the Year 2000 and Asian Law Firm of the Year (Pro Bono) 2001 by the International Financial Law Review, a Euromoney publication.

In an Asia survey by International Tax Review (September 2003), we were voted as a top-ranking law firm and recognized for our cross-border structuring work.

Our research oriented approach has also led to the team members being recognized and felicitated for thought leadership. NDAites have won the global competition for dissertations at the International Bar Association for 5 years. Nishith Desai, Founder of Nishith Desai Associates, has been voted 'External Counsel of the Year 2009' by Asian Counsel and Pacific Business Press and the 'Most in Demand Practitioners' by Chambers Asia 2009. He has also been ranked No. 28 in a global Top 50 "Gold List" by Tax Business, a UK-based journal for the international tax community. He is listed in the Lex Witness 'Hall of fame: Top 50' individuals who have helped shape the legal landscape of modern India. He is also the recipient of Prof. Yunus 'Social Business Pioneer of India' – 2010 award.

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).

Please see the last page of this paper for the most recent research papers by our experts.

Disclaimer

Contact

For any help or assistance please email us on concierge@nishithdesai.com or
visit us at www.nishithdesai.com

Contents

Executive Summary

Over the past two decades, strategic investments in the *not-for-profit/*social sector space have grown manifold. Many private foundations, endowment bodies and corporate houses have started to set up and support *non-profit* entities with special focus on social and environmental benefits. Not-for-profit sector has started to be seen as a strategic area with huge potential for socio-economic benefits aligned with the objectives of good corporate citizenship.

With increased funding and private sector participation, the demand for higher organizational competence and efficiency has also become stronger for non-profit entities. The evaluation and monitoring process has become an important tool for measuring the administrative capabilities of not-for-profit entities. In recent times, many independent auditors have closely monitored their performance, accountability and organizational transparency. It has also been observed that many non-for-profit organizations seek professional assistance for voluntary compliances of legal audit requirements. Such voluntary compliances re-enforces the 'trust premium' status enjoyed by non-for-profit entities and helps in attracting genuine funders, foreign donors and CSR funds.

Moreover, with the enactment of provisions on corporate social responsibility ("**CSR**") in the Companies Act, 2013 ("**Companies Act**"), the need for having a robust compliance framework and audit criteria for setting up and regularly monitoring the governance of not-for-profit entities have also attracted higher attention as the risk and liability for non-compliance with the new regulatory regime could be significant.

This paper attempts to cover issues regarding the implementation of 'good governance practices' in the social sector space, CSR reporting and compliances, utilization of foreign contribution, usage of efficient tax models etc. vis-à-vis the existing legal framework that govern charity laws in India. It also aims to outline the strategic, administrative, legal and regulatory challenges faced by NGOs in order to make their operations sustainable and impactful while being compliant with applicable laws.

1. Introduction

With the new CSR regime firmly in place, India's social sector space will witness newer forms of corporate philanthropy, and a governance template for institutional philanthropy would be urgently required in order to enable structural and process-related outcomes grounded in legal determinants.

The recent passage of the Companies (Corporate Social Responsibility) Rules, 2014 ("**CSR Rules**") has brought a sharp focus on the social participation and accountability of corporates. The CSR Rules articulate the policy and regulations to provide legal and organizational governance to CSR regime. With this, there is a need to develop a mechanism to measure philanthropic impact, and improve the transparency and governance of non-government organizations ("**NGOs**") receiving voluntary contributions and CSR funds.

However, there is an absence of comprehensive indicators on the basis of which NGO could be evaluated within legal parameters. Some funders have prescribed voluntary governance audits in their charter documents to scrutinize recipient NGOs on their fiscal health and outreach of their social activities. Such voluntary governance audits offer a powerful participatory tool to ensure transparency among recipients. However, due to the lack of legal or credible third-party monitoring, a key question is whether such voluntary, non-standard and sporadic governance audits have any impact on the improvement of the service delivery and creation of positive philanthropic endeavors and how do these audits accord with the regulatory environment, institutional deficiencies, accountability and management practices of NGOs in India?

The Companies Act vide Section 135 has, for the first time, introduced the concept of 'corporate social responsibility' into the legal lexicon. The existing space governing the not-for-profit sector mainly relies on five important statutes. They are:

- The Registration of Societies Act of 1860 and state-specific societies' laws enacted by different states
- A variation of the Indian Trusts Act of 1882 is in operation in different states. Maharashtra and Gujarat have offices of the Charities Commissioner to oversee charitable activities through the Bombay Public Trust Act, 1950; Tamil Nadu has a department of Religious and Charitable Endowments, and other states have similar arrangements for charitable trusts
- The Companies Act, in particular Section 8, Section 135 and Section 149, CSR Rules and Schedule VII of the Companies Act
- The Income Tax Act, 1961 ("**ITA**") with respect to providing fiscal benefits to non-profit entities, administered through the Directorates of Income Tax (Exemption) The Foreign Contribution Regulation Act, 2010 ("**FCRA**") enacted to meet the special condition of inflow of foreign funds to charitable organizations

In the following sections, we provide the overarching framework of legal and administrative considerations for the evaluation of not-for-profit entities in India and also discuss their evaluation and audit aspects. Finally, we refer to a detailed checklist that would broadly captures governance, auditing and evaluation indicators of such entities in India.

2. Legal and Administrative Framework

The not-for-profit sector has grown within a very basic legal and administrative framework, and that basic framework sets out the parameters within which the social sector operates. The lack of clarity on legal and administrative compliances has rendered the framework slightly restrictive and prone to misuse. Following are several key elements concerning evaluation process for non-profit entities that form part of the framework:

I. Legal

The regularization of compliance work should be high on the priority list of non-profit entities and all steps must be taken to ensure that internal audits are conducted periodically for legal processes and compliances are in place. Such internal evaluation and assessment of legal and compliance audit can prove to be an effective tool to account for changes in policies and law, and help in developing steps to eliminate organizational bottlenecks. By being meticulous in internal evaluation of regulatory compliances, a culture of cost-effective system can be put in place to ensure timely adherence to legal, financial and regulatory mandates.

Foreign contributions as donations or grant whether simple or project related, is an important source of income for charitable entities. Since the nature of charitable work NGOs carry often entail engaging with multiple agencies including government, having a transparent and accountable organizational system instills a sense of confidence and participation in the minds of foreign funders. Non-profit entities must bear in mind that non-utilization or mis-utilization of funds and lack of a transparent and accountable system may drive the donors away in the longer run.

Given the current spate of civil society movements taking place across various parts of the country, NGOs are under scrutiny like never before. Moreover, with the emergence of social media where dissemination of information has become lightening quick, organizations now need to be more careful in protecting the sanctity of their brand value, goodwill and donor's reputation.

Additionally, the Companies Act has special requirements for CSR compliance for companies mandated to conduct CSR activities under the Companies Act. They are:

i. Constitution of a CSR Committee of the Board of Directors consisting of three or more directors

ii. In case of listed public company, presence of an independent director on the Board

iii. Formation of a CSR Policy indicating the list of CSR activities to be undertaken

iv. Annual CSR Reporting to be included in the Board's Report as prescribed under the CSR Rules

II. Governance

i. *Mandatory provisions for governing documents.* The memorandum and articles or bye-laws or trust deeds (as the case may be) must contain certain minimum provisions containing operation and governance aspects of the organization. Charitable purpose(s) of the entity must be clearly stated in the governing document, and the charitable purpose for which the entity is incorporated should broadly fall within the definition of 'charitable purpose' as per section 2(15) of ITA.

ii. *Optional provisions for governing documents.* Non-profit entities should have flexibility in its bye-laws and should contain non-specific discretionary clauses empowering the Board or the Governing Council to set out and make changes to the governance structure and operations of the organization within the limits provided by the law.

iii. *Governing documents should be reflective.* The governing document should be well thought and should reflect the ideas and philosophies of the organization.

iv. *Internal reporting and oversight.* The governing body of a non-profit entity should be required either by law or through the governing documents to receive and approve reports on the finances and operations of its entity. The documents should provide that all due care and diligence is maintained with regard to non-disclosure of confidential information about the organization.

v. *Conflicts of interest.* Due care must be taken to ensure that the founders, officers, board members, and employees should not have any actual or potential conflict between their personal or business interests and the interests of the organization. Independent directors can be on the Board of charitable corporations subject to the condition that she/he or any of her/his relatives should not be related parties i.e. such independent directors should not be the Chief Executive or director of any organization that has received twenty-five percent or more of its receipts from the donor company, its promoters, directors or its holding, subsidiary or associate company or that holds two per cent or more of the total voting power in the company. Family foundations or charitable corporations may have family members on the Board. However, independence of the Board must be maintained with the presence of independent members who act as trusted advisors.

vi. *Resident status of governing council members.* Non-profit entities should be aware of certain regulatory issues that may arise in case of foreign citizens acting as trustee members or subscribers of a section 8 companies. Although the Citizenship Act, 1955 ("**Citizenship Act**") does allow certain economic and social rights to PIO (person of Indian origin) and OCI (overseas citizens of India) card holders, it may be administratively difficult to appoint foreign as trustees. Moreover, doing so may also pose certain regulatory challenges which can be both tedious and time consuming.

vii. *Prohibition on the distribution of profits or dividend or private benefits in any other manner.*

   a. No earnings or profits of the charitable entity can be distributed to any members or employee or to any other person. Income earned by the trust must be ploughed back into charitable activities.

   b. No distribution of assets or proceedings can be made to members upon the dissolution of the entity. Assets, earnings, and profits shall not be used to provide special personal benefits, directly or indirectly to any founders, members, officers, board members, employees, or donors connected with the charitable entity.

viii. *Self-Regulation.* Charitable entities must take steps to set higher standards of conduct and performance through self-regulation.

ix. *Composition of the Board.* In order to capture best practices and ensure informed oversight, non-profit organizations must appoint independent members from entity's area of work.

III. Regulatory

i. *Fundraising activities* – General Rule. Charitable entities must raise fund legally and should not indulge in any lobbying activity in lieu of funds or grants promised. Lobbying in any form is not permitted under the Indian laws.

ii. *Economic activities.* Should only engage in charitable activities and lawful economic, business, or commercial activities, provided that (i) the charitable entity is active solely and principally for the purpose of conducting appropriate non-profit-activities, and (ii) that no profits are distributed as founders, members, officers, board members, or employees and used solely for charitable purposes.

iii. *FCRA approval.* The entity must ensure that prior permission or registration is received by the central government before accepting any foreign contribution.

iv. *Usage of foreign funds not unrestrictive.* The charitable entity should ensure that no part of the contribution is used for activities not permitted under the FCRA.

v. *Citizenship.* Charitable organizations must be mindful of the fact that foreign citizen or a Person of Indian Origin or an OCI (Overseas Citizen of India) card holder are generally discouraged to be appointed as trustee or governing council member of a charitable entity. Such members may, however, serve the entity in an ex-officio capacity.

vi. *Directors.* In case of a section 8 company, at least one resident director must be appointed who has stayed in India for a total period of 182 days in previous calendar year.[1]

vii. *Annual Meetings.* Board meeting must be held at least once a quarter and minutes of the meeting must be maintained. The shareholders or members of the company must meet each year in the Annual General Meeting.

1. Section 149(3) of the Companies Act lays down certain criteria for appointment and qualification of directors. This clause is introduced to ensure that at least on director is resident in India in order to ensure regular functioning of the organization.

3. Important Issues

I. Governance

With respect to best governance practices, a trustee acts in a fiduciary capacity and has certain responsibilities and obligations regarding the operation of the trust. The Board or the Governing Council plays an important role in good governance practices. Measures should be taken to ensure that members do not have conflict of interests. Board members should be closely involved with functioning of the organization and maintain fiduciary relations with the trust. 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. A public trust is subject to public scrutiny and court enquiry and directions, all the trustees, would be subject to such public scrutiny and the jurisdiction of Indian courts.

II. Reconciliation between Charitable and Commercial Activity

Reconciliation between charitable and commercial activities have also been contentious for certain category of non-profit entities from tax perspective. Due care must be taken to ensure that nature of charitable activities carried out by non-profit organizations come fall under first five limbs of section 2(15) of ITA. Charitable entities falling under the last limb should not carry any commercial activity if not directly connected to its main objective. Moreover, annual gross receipts for such entities should not exceed INR 25 lakh in the previous year.

III. Foreign Nationals

All due care must be taken to ensure that foreign nationals should not be made board or governing council members of charitable trust or society. Although there is no bar on in law against foreign nationals on the board of trustees of a public trust registered in India, there is a degree of sensitivity regarding their appointment by statutory bodies or authorities. Presence of foreign nationals on the Board may lead to greater scrutiny by law agencies and lead to greater interference in day to day activity of the organization.

IV. Foreign Contribution

FCRA is very stringent in its operation and utmost care must be taken to ensure that NGOs accepting foreign contribution adhere to timely compliances of annual filing as prescribed under FCRA.

V. Direct Tax

Surplus income in excess of INR 25 lakh is taxable for such category of non-profit entities that are engaged in 'advancement of general public utility'. As the meaning of 'incidence of business' has been changing through judicial pronouncements, every category of NGOs falling under Section 2(15) of ITA must not engage in unrelated business.

4. Areas of Evaluation

I. Formation Compliances

A non-profit entity may be registered:

a. As a charitable trust

b. As a society under the Societies Registration Act, 1908

c. As a licensed company under Section 8 of the Companies Act

Formation as a charitable Trust

Documents required

- *Trust deed, and*
- *Rules and Regulations*

The trust deed should contain the following clauses

- the names of the author(s)/Settlor(s) and trustees of the trust
- the property that shall devolve upon the trustee(s) under the trust for the benefit of the beneficiary/ies;
- An intention to divest the trust property upon the trustee(s);
- The objects of the trust;
- The procedure for appointment, removal or replacement of a trustee, their rights, duties and powers, etc.;
- The rights and duties of the beneficiary/ies;
- The mode and method of determination of the trust.

Registration

In case of public charitable trusts, whether in relation to a movable property and created under a will or *inter vivos,* registration is optional but desirable. However, in case of a charitable trust in relation to an immovable property, for claiming exemption u/s 11 of the Income Tax Act, it is essential that the instrument of trust is duly registered.

i. Registration of Trust Deed under Indian Registration Act

An instrument assigning any right, title or interest in an immovable property of value exceeding Rs.100, is required to be registered under the Registration Act, 1908. Thus, a trust deed involving an immovable property must be registered.

ii. Laws Applicable to Trust

- Charitable and Religious Trusts Act, 1920
- Religious Endowments Act, 1863
- General principles of Indian Trusts Act, 1882

iii. Formation as a Society

As per the Societies Registration Act, (1860) a society can be formed by minimum seven (or more) persons, eligible to form a charitable society.

iv. Documents Required

- Memorandum of Association, and
- Rules and regulations

v. MoA should Contain the following Clauses

- Name of the society
- The registered/principal office of the society
- The objects of the society
- The names, addresses and occupations of the members of the governing body whether called as Governors, Councilors, Directors, etc., to whom, by the rules of the society, management of its affairs is entrusted, and
- The names and addresses of the persons (at least seven) subscribing to the memorandum. The signatures of the subscribers should be duly witnessed and attested by the Oath Commissioner/Notary Public/Gazetted Officer/ Advocate/Chartered Accountant/ Ist class Magistrate.

vi. Formation as a Section 8 Company

- Memorandum of Association
- Articles of Association

vii. The Memorandum should Contain the following Clauses

- The entity is formed for the promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or other useful object
- Application of profits or other income for the promotion of above objectives
- Dividend distribution to be prohibited and profits, if made, to be ploughed back into the company

II. Functional Documents

A. Annual Reporting

Societies Registration Act, 1908 - Annual list of managing body to be filed with the Registrar of Joint-stock Companies, of the names, addresses and occupations of the governors, council, directors, committee, or other governing body then entrusted with the management of the affairs of the society.

The Karnataka Societies Registration Act, 1960 - report of the annual general meeting along with an audited copy of the balanced sheet, income and expenditure account and the auditor's report to be filed with the Registrar.

Madhya Pradesh Society Registrikaran Adhiniyam, 1973 - a list of governing body members to be filed with the Registrar annually. Statement of income and expenditure with full particulars duly checked by the auditor, audit report and balance-sheet of the previous year.

Bombay Public Trust Act - A trustee of a public trust which has an annual income exceeding the prescribed amount shall, at least one month before the commencement of each accounting year, prepare and submit in such form or forms as may be prescribed, a budget showing the probable receipts and disbursements of the trust during the following year to the Charity Commissioner.

Annual Return for a Section 8 company - A Section 8 Company having a share capital or limited by members shall prepare and file a return depending upon the nature of incorporation whether as limited by Shares or members containing the following particulars before the RoC-

B. Tax Compliances

The government provides both direct and indirect tax benefits to non-profit entities in order to improve their resource mobilizations. In order to avail tax benefits, the entity must satisfy the criteria of "charitable purpose" for the purpose of income-tax registration and availing exemptions under the ITA. The term "charitable purpose" includes relief of the poor, education, medical relief, preservation of environment and preservation of monuments or place of objects of artistic or historic interest and advancement of any object of general public utility.[2] The first five classes of charitable activities fall under the 'dominant' category while the *general public utility* comes under the residual category. Assessment of income earned by non-profit entities and the amount liable to be exempted by the Assessing Officer depends largely on the dominant and the residual category entity.

i. The primary or the dominant object of the non-profit entity must fall within the dominant category under section 2(15)) of the ITA.

ii. A non-profit entity can have a combination of charitable and non-charitable objects provided the latter is carried out in furtherance of its main objects.

---

2. As per section 2(15) of the Income-tax Act, the term "charitable purpose" includes relief of the poor, education, medical relief, preservation of environment and preservation of monuments or place of objects of artistic or historic interest and advancement of any object of general public utility. In case of a NGO engaged in the advancement of object of general public utility, the activities shall not be considered as "charitable purpose" if:
   i. it involves the carrying on of:
      a. Any activity in the nature of trade, commerce or business; or
      b. Any activity of rendering of any service in relation to any trade, commerce or business,

      For a fee or cess or any other consideration, irrespective of the nature of use or application of the income from such activity, or retention of such income, by the concerned entity; and
   ii. the total receipts from any such activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business exceeds INR 25,00,000 in the previous year.

iii. Recent amendment to the definition of 'charitable purpose' under section 2(15) has significant implications and organizations falling under the last category should be mindful of not having gross receipts from trade, commerce or business in excess of INR 25 lakh.

iv. Peripheral business activities should affect exemption status for non-residual category NGOs if the same is carried with commercial motive or profiteering.

v. Charitable organizations should make an application for registration before the Commissioner to avail benefits under section 12A of ITA.

vi. The Commissioner of Income-tax (Exemptions) is empowered to cancel registration under section 12AA(3) of ITA if the activities of such trust or institution are not genuine or are not being carried out in accordance with the objects of the trust or institution

vii. Registration under section 12A of ITA is a mandatory pre-condition to avail of income-tax exemptions but mere registration does not entitle the organization to claim registration. Registration is, therefore, a condition precedent for availing exemptions.

viii. Non-profit entities are required to apply for registration within one year from the date of its creation. It should submit the audited report at the time of applying for registration.

ix. Deemed registration if order for registration not passed by the Commissioner of Income-tax within six-month's time limit.[3] The funds of the organization to be invested /deposited only in approved securities as specified under Section 11(5) of ITA.

x. All charitable organizations having total income exceeding the maximum amount which is not chargeable to income tax during the previous year are required to file their returns of income.

xi. Application for approval under 80G to be made after obtaining certificate of registration under section 12AA of ITA. Section 80G provides deduction to donors in the computation of his/her taxable up to 100 per cent of the donation made.

Issues/Concerns

- Meaning of 'business' and 'charitable activity' is not very broad
- Business activity considered as a part of charitable activity only in certain cases
- A particular class of NGO[4] [incorporated for general public utility] is exposed to higher risk of losing its exemption as a charitable entity if it carries any activity in the nature of trade, commerce or business irrespective of whether such activities are incidental. Provisions of section 11 to 13 may not be applicable to such entities.
- Exemptions under section 12A of ITA would not by itself be adequate to claim compensation because income-tax exemptions depend not merely on registration and an organization duly registered can still be denied exemption, if provisions of section 11 of ITA are not followed.
- Any income applied on activities outside India is not eligible for exemption under section 11(1)(c) of the Income-tax Act. Although Section 10(23C)(vi) is silent about the place of activity, it is now an accepted principle that NGO registered under the above section are also required to have activities in India.

C. FCRA Compliances

The FCRA regulates foreign contribution made to *for-profit* as well as *non-profit entities* in India. The provisions under FCRA are stringent in nature with many regulatory compliances to follow failure of which may lead to frequent MHA's oversight and subsequent cancellation of 'registration' of the concerned entity. The entity seeking a certificate of 'registration' or 'prior permission' under FCRA should ensure that all the documents are in place and books of account are duly audited. Recently, the Ministry of Home Affairs ("**MHA**") cancelled registration of nearly four thousand non-profit organizations for violation of FCRA provisions.[5]

- The body seeking foreign contribution must be a registered body
- Foreign contribution is open to both for-profit as well as not-for-profit entities
- Foreign contribution may be received by entities having a definite cultural, social, economic, educational or religious programs
- FCRA registration is granted to such organization having a proven track record in

3. Manoj Fogla, *Taxation of Trusts and NGOs* 179 (Taxmann Publications (P.) Ltd., New Delhi, 6th edn., 2012)
4. Manoj Fogla, *Taxation of Trusts and NGOs 51* (Taxmann Publications (P.) Ltd., New Delhi, 6th edn., 2012)

its chosen field of work during last three years. Thus, organizations that are less than three years old are ineligible for FCRA registration.

- Newly established organizations having no proven track record of activities are permitted to seek foreign contribution for specific activities, for a specific purpose and from a specific source after seeking prior permission
- A designated bank account needs to be maintained and no local funds to be mixed or operated from the designated account
- An entity granted prior permission or registration is required to carry out the activities[6], for which foreign contribution is received, and no amount should be allowed for purpose other than for which it is received
- Annual Returns to be filed mandatorily before the MHA
- All due care must be taken to ensure that foreign contribution account is not mixed with the account of domestic receipts
- No foreign contribution to be invested in mutual funds or other speculative investments
- No foreign contribution to be transferred to any NGO unregistered under FCRA, without prior approval of the Government of India.

Issues/Concerns

- The accounting statement needs to be preserved by the entity for a period of six years.
- Not more than 50% of the foreign contribution to be defrayed to meet administrative expenses of the entity.
- The definition of foreign source is very wide in amplitude to cover even domestic companies within the meaning of Companies Act, if more than one half of the nominal value of its share capital is held, either singly or in aggregate, by a foreign source.
- Any delivery or transfer made a foreign trustee of the Indian trust, in India, shall also be construed as a foreign contribution
- Due care should be taken to ensure that the foreign members is not made a trustee or a board member. She/he may, however, be made an ex-officio member in the governing or executive council subject to certain conditions.
- Capital assets purchased out of foreign contribution should only be acquired in be name of the recipient entity.
- Inter-transfer of foreign funds to other organization is restricted. Any recipient organization being substantially funded by the State and statutorily audited by the Comptroller and Auditor General of India (“**CAG**”) may transfer foreign contribution to other entities and is totally exempt from the operation of all provisions of FCRA.

5. http://newindianexpress.com/nation/Centre-acts-tough-on-NGOs-failing-to-submit-returns/2013/05/07/article1578313.ece. Website last visited on August 6, 2013
6. http://resolveindia.wordpress.com/2012/12/20/fcra-guidelines-procedures-faq-foreign-contribution-regulation-act-2010/

5. Concluding Comments

Social Audit is a tool through which organizations can plan, manage and measure financial as well as non-financial activities and monitor both internal and external consequences of its social and commercial operations.

Social audit can also be used as an effective tool by international organizations, industry bodies and think-tanks to implement international legal framework and initiatives. Similarly, the audit process provides an ample scope to include initiatives proposed by UN Global Impact which relates to ten universally accepted principles in the area of human rights, labor, environment and anti-corruption. As India is a signatory to a number of international guidelines with regard to corporate social responsibility, the significance of social audit process becomes manifold.

The social audit process can, become a pre-cursor to the corporate social responsibility movement.

The guiding principles of OCED's Responsible Business Conduct provide a unique implementation mechanism for social audit by incorporating comprehensive approaches to due diligence and responsible supply chain management. Although Social Audit is a voluntary process and an independent evaluation of the performance of an organization, it truly reflects the expectations of the stakeholders while not losing sight of the financial health of organizations. It is, thus, an instrument of social and financial accountability of an organization. Pursuant to the above guidelines, there has been a clearer understanding of the way organizations need to operate in order to minimize the risks attached to its business governance that affects people and its eco-system. Such guidelines reflect good business practices and create a healthy environment for all stakeholders.

Annexure

Standard Checklist for NGOs

Documents	Availability
Cover letter with organizations basic details, current operations, contact details	Mandatory
Registration certificate	Mandatory
Registration Certificate under Section 12A under Income Tax Act, 1961	Mandatory
Audited Accounts of last three years	Mandatory
IT Exemption Certificate under Section 80G	If available
Acknowledgement of Income Tax Return along with IT Return filed (last three years),	Mandatory
FCRA Certificate and latest copy of FCRA Return FC-3	If available
Duplicate copy of pan card	Mandatory
Annual Reports of last 3 years	mandatory
Narrative Project Report	mandatory

Auditors' Checklist for NGOs

A. General

Name of the organization	
Established year	
Registration Details (Act and Reg. No.)	
Date of Registration	
Type of organization (Whether NGO/trust/Foundation/Institution/Section 25 company)	
Exemption- I.T/S-11	
Established year	

Contact Information

Registered office	
Phone Nos.	
Fax	
Email	
Website	
Field Office Address	
Established year	

Vision/Mission and Core Value Statement

Objectives

Geographical Working Area(s)

In line with target area?	**Yes**		**No**	

Key thematic Sectors of Operations

Target Population

B. Organizational Elements (Governance Checklist)

Does the Organization have an Independent Board?	Yes		No	
Frequency of Board Meetings –date of last meeting				
In last 2 years what was the shortest gap between meetings? (In months)				
In the last 2 years what was the longest gap between meetings? (In months)				

Board Members

	Name / Address	Occupation (or past occupation, if retired)	Relation to other senior office bearer, including Board/CEO/staff	Money value of all benefits received from board function, annually
1				
2				
3				
4				
5				

Chief Executive/Functionary

Name				
Date of Appointment				
Is Chief Executive the Founder of the Organization?	yes		no	
Does Chief Executive work full time with the org	yes		no	
If No, then what is the other occupation; provide details				
Is s/he member of any network-Govt. or otherwise; if yes, names				
Chief Executive's Contact Details:				
Phone No.(s):				
Email:				

C. Finance and Administrative Elements

Foreign Currency Receipts

Can the Organization receive Foreign Currency?	yes		no	
Registration Details: (Act & reg. number)				
Date of Registration:				
Has latest FCRA return been filed? Period and date of filing				

Details of Past Budgets: (Details of last 3 years)

Financial Years	Total Income (Rs in Lakhs)	Total Expenditure (Rs. in Lakhs)
Start		end

Details of Past and Present Institutional Donors: (For 3 years)

Financial Year	Donor Agency/ Govt. Body	Foreign /Indian	Total Contribution (Rs. in Lakhs)	% of Income	Purpose of Grant/ Donation

Details of Own Resources including corpus, if any

Financial Year	Nature of Resources	Total Contribution (Rs in Lakhs)	% of Income

Audits

Does the organisation have a regular internal audit system? In-house / external-Name and address	Yes		No	
Period for which last internal audit report is available				
Does the organisation have a statutory auditor?	Yes		No	
Name and address of the statutory auditor				
Year since when the above firm has been the organisation's statutory auditor				
Does the organisation publish/bring into public domain, the annual accounts?	Yes		No	
What form in which the annual accounts has been brought to public domain?				
Latest year for which accounts published				
Does the organisation share its financial statements with the target communities? If yes, how?				

Procedures

Set of administration instructions/procedures available?	Y		N	
Policy on segregation of duties?	Y		N	
Policy on fraud, theft, malfeasance and misappropriation?	Y		N	
Purchasing process ensures best value?	Y		N	
Appropriate cash disbursement system?	Y		N	
Payments supported with original bills etc	Y		N	
Regular bank statements available?	Y		N	
Periodic reconciliation of accounts?	Y		N	
Fixed assets records maintained?	Y		N	
Inventory records maintained?	Y		N	
Accounts - manually maintained or computerised?	Manual		Automated	
Cash/bank book- manual or computerised	Manual		Automated	
Rough cash book maintained?	Y		N	
Integrated (joint) books of accounts maintained for all funders with separate funder wise ledgers?	Y		N	

Provided upon request only

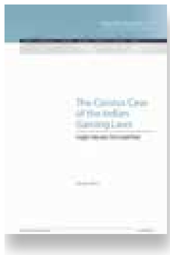
The following research papers and much more are available on our Knowledge Site: www.nishithdesai.com

Fund Structuring and Operations

June 2015

E-Commerce in India

July 2015



The Curious Case of the Indian Gaming Laws

September 2015

Corporate Social Responsibility & Social Business Models in India

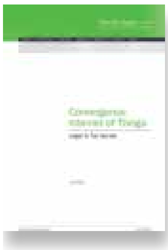
March 2015

Joint-Ventures in India

November 2014

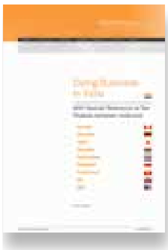
Outbound Acquisitions by India-Inc

September 2014



Convergence: Internet of Things

July 2015



Doing Business in India

June 2015

Private Equity and Private Debt Investments in India

June 2015

NDA Insights

TITLE	TYPE	DATE
Thomas Cook – Sterling Holiday Buyout	M&A Lab	December 2014
Reliance tunes into Network18!	M&A Lab	December 2014
Sun Pharma –Ranbaxy, A Panacea for Ranbaxy's ills?	M&A Lab	December 2014
Jet Etihad Jet Gets a Co-Pilot	M&A Lab	May 2014
Apollo's Bumpy Ride in Pursuit of Cooper	M&A Lab	May 2014
Diageo-USL- 'King of Good Times; Hands over Crown Jewel to Diageo	M&A Lab	May 2014
Copyright Amendment Bill 2012 receives Indian Parliament's assent	IP Lab	September 2013
Public M&A's in India: Takeover Code Dissected	M&A Lab	August 2013
File Foreign Application Prosecution History With Indian Patent Office	IP Lab	April 2013
Warburg - Future Capital - Deal Dissected	M&A Lab	January 2013
Real Financing - Onshore and Offshore Debt Funding Realty in India	Realty Check	May 2012
Pharma Patent Case Study	IP Lab	March 2012
Patni plays to iGate's tunes	M&A Lab	January 2012
Vedanta Acquires Control Over Cairn India	M&A Lab	January 2012
Corporate Citizenry in the face of Corruption	Yes, Governance Matters!	September 2011
Funding Real Estate Projects - Exit Challenges	Realty Check	April 2011

Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm's culture.

Research has offered us the way to create thought leadership in various areas of law and public policy. Through research, we discover new thinking, approaches, skills, reflections on jurisprudence, and ultimately deliver superior value to our clients.

Over the years, we have produced some outstanding research papers, reports and articles. Almost on a daily basis, we analyze and offer our perspective on latest legal developments through our *"Hotlines".* These *Hotlines* provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our *NDA Insights* dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research papers and disseminate them through our website. Although we invest heavily in terms of associates' time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with a much needed comparative base for rule making. Our *ThinkTank* discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

As we continue to grow through our research-based approach, we are now in the second phase of establishing a four-acre, state-of-the-art research center, just a 45-minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. The center will become the hub for research activities involving our own associates as well as legal and tax researchers from world over. It will also provide the platform to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear from you about any suggestions you may have on our research reports. Please feel free to contact us at
research@nishithdesai.com

Nishith Desai Associates
LEGAL AND TAX COUNSELING WORLDWIDE

MUMBAI

93 B, Mittal Court, Nariman Point
Mumbai 400 021, India

tel +91 22 6669 5000
fax +91 22 6669 5001

SILICON VALLEY

220 S California Ave., Suite 201
Palo Alto, California 94306, USA

tel +1 650 325 7100
fax +1 650 325 7300

BANGALORE

Prestige Loka, G01, 7/1 Brunton Rd
Bangalore 560 025, India

tel +91 80 6693 5000
fax +91 80 6693 5001

SINGAPORE

Level 30, Six Battery Road
Singapore 049 909

tel +65 6550 9856

MUMBAI BKC

3, North Avenue, Maker Maxity
Bandra–Kurla Complex
Mumbai 400 051, India

tel +91 22 6159 5000
fax +91 22 6159 5001

NEW DELHI

C–5, Defence Colony
New Delhi 110 024, India

tel +91 11 4906 5000
fax +91 11 4906 5001

MUNICH

Maximilianstraße 13
80539 Munich, Germany

tel +49 89 203 006 268
fax +49 89 203 006 450

NEW YORK

375 Park Ave Suite 2607
New York, NY 10152

tel +1 212 763 0080

