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Draft tax code takes a toll on charities

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The draft **Direct Taxes Code** (DTC) that proposes a lower tax regime particularly for those with below Rs 25 lakh annual income, has its darker side, too - it is set to make survival difficult for trusts and charitable institutions in India. The tax code, also under attack for seeking to bring back the 'distrustbased' taxation system, will replace the trust-based tax regime followed in the last 25 years. Experts see these provisions, encapsulated under the General Anti Avoidance Rules (GAAR), becoming a big impediment to charitable institutions.

"Donors may not get deductions for pure charitable contributions due to the applicability of GAAR provisions. Under the proposed GAAR provisions, transactions not having commercial purpose could be considered impermissible," said Nishith Desai, founder of Nishith Desai Associates and recipient of Prof. Yunus Social Business Pioneer of India- 2010 award.

The tax officials are also empowered to probe into the commercial justification of the arrangements entered into by the tax payers, thus, choking some fund raising channels for charities. Such impermissible transactions attract tax on the part of the donor.

"Normally, not for profit organisations (NPOs) bring out a booklet and collect donations from commercial establishments and patrons in the form of advertisements. Incidentally, it is considered a commercial act under the DTC," said Sandeep Bhalla, executive director of KPMG. The definition of charity itself is so skewed that the draft does not consider many such acts as charities.

It also puts impediments in the cross-border charities. "For inbound foreign donations FCRA (Foreign Currency Regulation Act) is applicable. The inflows are deemed to be considered income and taxed at 15 per cent. The **Income Tax** (I-T) Act does not allow outbound charity totally," said Desai.

It does not incentivise reciprocation of charitable acts of other peoples and countries. For example, Japan and its people have come forward with donations whenever India suffered from natural calamities. "However, beyond small non-tax deductible contributions, it may not be possible to reciprocate when earth quakes and tsunami devastated several parts of that country," Desai added. However, the government does not prohibit the same.

"'Do it. But pay taxes on them,' it says," said Bhalla. DTC has brought in absolute discretion to I-T authorities. The change of mind is considered retrograde. The trustbased system had resulted in higher tax compliance and collections over the last 25 years. Paradoxically, the intention is to ensure much higher compliance, which was not forthcoming through the 'distrust-based' regime three decades ago.

Citing these reasons, besides many other anomalies, experts and legal pundits have called for a complete overhaul of the draft. "While developing this law, the government did not involve economists, lawyers, policy thinkers, chartered accountants, sociologists or legislative draftsmen… The draft DTC is full of errors and many proposals need complete overhaul before it is passed (by Parliament)," said Desai.