

# Governance & Disclosure Practices

Learning Series for Voluntary Organisations, Vol.-II, Issue - I, 2013-14

## Fundamental Attributes of NPOs You Should Know



A joint initiative of Credibility Alliance & Oxfam India



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Improving Governance Building Trust

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## Fundamental Attributes of NPOs You Should Know

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\* The Advisory support members have contributed to the document, however, the entire content is not necessarily the opinion of the advisory group.

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The word "Foreword" is written in a green, elegant cursive font. The letter "F" is significantly larger and more decorative than the rest of the word. The text is set against a light green, triangular background that points towards the top-left corner.

*We are well aware of the fact that Voluntary Organisations (VOs) are non-profit in nature.*

*Beyond this very little is known about the characteristics of these VOs.*

*They can be classified into various types on the basis of different factors like orientation or level of cooperation.*

*VOs that are classified by level of co-operation are generally known as Community- Based Organisation; National NGOs; and International NGOs;*

*Beyond the various terminologies, the NGOs also differ in their purpose, nature and functions. It is noteworthy to know the distinction between various models of Societies such as Co-operative Societies and Mutual Societies and how they are distinct from a non-profit organisation.*

*This Issue of CA Learning Series on Governance and Disclosure Practices discusses the various characteristics of VOs along with the meaning of the term “charitable” and diversity of the Voluntary Sector in India to enable deepen the perspective on Voluntary Organisations.*

*CA is grateful to all its Advisory Panel Support Members and the author, for their active, prompt and valuable inputs in fine tuning this Issue.*

**S. P. Selvi**

Executive Director,  
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# Fundamental Attributes of NPOs You Should Know

## Fundamental Characteristics of NPOs

**1.1.1** At the outset it is important to understand the legal and formal characteristic of an NPO, which are explained as under :

- (a) NPOs are private institutions :** Contrary to the common perception, NPOs are private institutions and should not be considered as public bodies. They are privately constituted institutions which may be privately managed. However, NPOs exist only for public purposes. For example, both public trust and private trust can be created with two or three persons (selected by the author of the trust) but a public trust cannot have any private objectives, it cannot work for the benefit of any individual or specific group of individuals. In law, one of the tests for determining a public trust is benefit accruing to “an uncertain and fluctuating body of persons”. It may further be noted that NPOs which are substantially funded by government (more than 50%) are generally treated as public institutions.
- (b) NPOs need not necessarily be registered :** It is not a legal necessity to formally register an NPO, a group of individuals may get together for a definite purpose and form an NPO. There are many oral trusts which are validly existing for centuries. However, for all practical purposes registration of an NPO is a necessity. Registration of NPO becomes important to avail various exemptions and rights under law.
- (c) NPOs are Formal institutions :** All NPOs are formal institutions irrespective of whether they are registered or unregistered. NPOs exist for a definite purpose having definite rules and regulations.
- (d) Self Governing :** As discussed above, NPOs are private institutions and therefore, they are self governing bodies. The members or the trustees of

the NPO have the legal right to determine the governance structure of the NPO.

- (e) **Not for Profit** : NPOs are not for profit organisations, however, it does not imply that NPOs cannot do commercial/business activity or cannot have profit. NPOs can engage in incidental business or profit making activity, however, NPOs should not have the intent of profit making and they cannot distribute any profit to any member or trustee. All income or profit of NPOs have to be used for charitable purposes only as defined under the applicable statutes.
- (f) **NPOs are Voluntary in nature** : The constitution and existence of NPOs is voluntary in nature. The members and the board/trustees work and participate without any personal interest. Everybody has to work voluntarily without drawing any personal benefit. In this context, it may be noted that any personal benefit does not include any legitimate and reasonable payment such as salary, wages, honorarium, consultancy etc. against services rendered.
- (g) **NPOs are Non Religious** : All charitable organisations are non religious in nature. It may be noted that even religious organisation are registered as NPOs however, in order to avail privileges under Income Tax and other laws, even religious organisations have to propagate the religious activities irrespective of caste, creed and religion.
- (h) **NPOs are for Public Benefit** : NPOs may be private institutions but they work and exist only for public purposes and public benefit. Public benefit does not mean they have to work for the entire population. NPOs may work for specific sections of the society but such section should be large and not a small definite group.
- (i) **NPOs are Non Political** : It should not be political. It may create political awareness but should not be involved in putting up candidates for elections or canvassing for them etc.

## Diversity in the NPO sector in India

- 1.2.1** Transparency and accountability of NPOs & charitable trusts always poses a great challenge because of the extreme diversity in terms of volume as well as nature of activities between the NPOs. One can find millions of small NPOs having total income within 2,00,000 to 3,00,000 rupees per annum. At the same time, one can also find NPOs handling in excess of 1000 million rupees per year. Therefore, NPOs vary from tiny to mega NPOs.

**1.2.2** In terms of the nature of activity, also NPOs function between radical extremes. Few instances of activities are as under :

- NPOs having relief activities with tangible deliverables as the one working immediately after a natural calamity such as flood, cyclone, earthquake, etc;
- NPOs having a rehabilitative mission such as the NPOs who work for the rehabilitation & reconstruction after calamities & unfortunate happenings;
- NPOs focussing on awareness and capacity building of people without having any tangible deliverable component;
- NPOs engaged in vocational training and employment generation programmes;
- NPOs engaged in counselling and psychological support;
- NPOs working as networks of smaller NPOs to mobilise people across the country/state for their rights and well-being;
- NPOs working as activists against various social, legal and political issues.

**1.2.3** In terms of the form and operations too, the NPOs are very diverse. Some instances are as under :

- i) International Agencies working in India. There are few agencies which are directly working in India. For example, CARE, is an international NPO working in India for the last 60 years
- ii) International Agencies having liaison & branch offices in India
- iii) Agencies registered in India but controlled by foreign NPOs
- iv) Networking NPOs
- v) CBOs (Community Based Organisations)
- vi) Federations of smaller NPOs and CBOs
- vii) NPOs engaged in research, capacity building, advocacy, lobbying etc.
- viii) CSR (Corporate Social Responsibility) Institutions
- ix) Microfinance Institutions
- x) Medical Institutions and Universities
- xi) Chamber of Commerce & Stock Exchanges.

## Distinguishing NPOs from Mutual Societies

**1.3.1** NPOs are distinct and different from a mutual society. A mutual society is an

organization, where a group of persons come together for the benefit of the members of that association or society so formed. A mutual society does not work with the outside world, the members from such society work for their own recreation/benefit. Another distinct feature of a mutual society is that such members have the right to claim the benefit from that society/association. Contrary to a mutual society, in an NPO, members cannot take any benefit from the society. The social clubs like “Rotary Club” or “Lions Club” are mutual societies as members get together and access various benefits. Another example of a mutual society could be the association of the flat owners in a large apartment. The mutual societies are thus different from NPOs.

**1.3.2** It may be noted that the income of mutual societies is also exempted from tax, not because they may or may not be doing charitable activities, but because they are exempted on the ‘principles of mutuality’. The ‘principles of mutuality’ states that since the contributor and the beneficiary are the same group of people therefore, the income is exempted.

**1.3.3** Certain inherent characteristics of a mutual society are as under :

- (i) A mutual society is an organization, where a group of persons come together for the benefit of the members of that association or society so formed.
- (ii) A distinct feature of a mutual society is that such members have the right to claim the benefit from that society/association which is not possible in the case of NPOs.
- (iii) The income generated from such societies are not subject to tax on the principles of mutuality. The reasons for tax exemptions to mutual society are :
  - (a) there is common identity of the contributors and recipients, in other words the contributors and beneficiaries are same.
  - (b) the mutual society is created or incorporated as an entity merely for the convenience of the members.
  - (c) there is impossibility of the contributors making profits from contributions made by themselves to a fund, which could either, be spent or returned back to themselves.
- (iv) The members should contribute as a class of homogenous group and they must be able to participate in the surplus in similar terms.
- (v) The individuals of a mutual society may be different at different times. But as long as the contributors and participators are both holding membership status and their identity is clearly established, only then the principles of mutuality would be available to them.



## Distinguishing NPOs from Co-operative Societies

- 1.4.1** NPOs are distinct and different from a co-operative society. A co-operative society is an organization, where a group of persons come together for the benefit of the members of that society so formed. For example a group of farmers may form a co-operative society for marketing their product. A co-operative society works for the benefit of its members whereas an NPO works for public benefit. Another distinct feature of a co-operative society is that such members have the right to claim the benefit, dividend or profit from the co-operative society. In an NPO members cannot take any benefit from the society.

## The term 'Charitable' is very Broad

- 1.5.1** NPOs are generally known as charitable organisations, the term charitable is too broad to include various diverse categories on organisations, the term charitable includes :
- Organisations engaged in scientific, cultural, social activities etc.
  - Religious organisations, though for income tax purposes religious organisations should specifically work for religious purposes only.
  - Organisations doing activities without having philanthropic activities i.e. having activities with reasonable profit. For instance, schools which survive on the fees collected from students are treated as 'charitable' even if they are making reasonable profit.
  - Even organisation such as stock exchanges and chambers of commerce have been considered as charitable organisation.

The bottom line for being a charitable organisation is to apply all its income and resources for its declared objectives without distributing any surplus to members or related persons or parties.

## Not for Profit does not mean cannot have Profit

- 1.6.1** NPOs are Not for Profit organisations, however, it does not imply that NPOs cannot do commercial/business activity or cannot have profit. NPOs can engage in incidental business or profit making activity, however, NPOs should not have the intent of profit making and they cannot distribute any profit to any member or trustee. All income or profit of NPOs have to be used for charitable purposes

only. The profit generated by a charitable organisation shall not, in principle, affect its charitable nature. However, if the motive primarily is to generate profit then the charitable nature can be questioned. In other words, profiteering is not permissible.

**1.6.2** It may further be noted that having income or profit does not imply that an NPO is commercial in nature. An NPO may have various sources of income which may includes :

- rent from properties,
- income from conference halls,
- income from one time activities such as charity shows, etc.,
- professional service related with expertise incidental to charitable work, etc.
- sale of khadi or the goods produced by beneficiaries, provided the activity is with the intent of serving the beneficiaries.

## Charitable Activity can also be run on Commercial Principles

**1.7.1** It has been held that charitable purpose need not necessarily be welfare or help oriented. Welfare activities done with an intent to earn reasonable profit can also be of charitable nature. In *CIT v. Pulikkal Medical Foundation* [1994] 210 ITR 299 (Ker.), it was held that eleemosynary element was not an essential ingredient of philanthropy. The Supreme Court ruling in the case of *P.A. Inamdar v. State of Maharashtra* AIR 2005 SC 3226/[2005] SCC 537 and in the case *T.M.A.Pai Foundation v. state of Karnataka* (2002) 8 SCC 481 held that 6 to 15% surplus for a charitable institution are reasonable for future sustenance.

## Definition of Charitable purpose & Charities Act, 2006 of UK

**1.8.1** “Charitable Purpose” generally implies working for the benefit of the poor and downtrodden, however, legally the definition is very broad to include various other activities which may not be towards benefit of the poor. Each country has a separate definition of “Charitable Purpose”. Generally, the charitable purpose is very broad and covers wide range of objectives including such as benefit of animals, trade associations, farmer associations, religious bodies etc. In this regard it is worthwhile to refer the Charities Act, 2006 of United Kingdom which provides

a very exhaustive definition of the term “charitable purpose” which is as under:-

- (a) The prevention of relief of poverty;
- (b) The advancement of education;
- (c) The advancement of religion.
- (d) The advancement of health or the saving of lives;
- (e) The advancement of citizenship or community development;
- (f) The advancement of the arts, culture, heritage or science;
- (g) The advancement of amateur sport;
- (h) The advancement of human rights, conflict resolution or reconciliation or the promotion of religious or racial harmony or equality and diversity;
- (i) The advancement of environmental protection or improvement;
- (j) The relief of those in need, by reason of youth, age, ill-health, disability, financial hardship or other disadvantage;
- (k) The advancement of animal welfare;
- (l) The promotion of the efficiency of the armed forces of the Crown or of the police, fire and rescue services or ambulance services;
- (m) Other purposes currently recognized as charitable and any new charitable purposes which are similar to another charitable purpose.

## Combination of Charitable and Non-charitable Objects

- 1.9.1** If there are several objects of the trust, some of which are charitable and some non-charitable, and the trustees have unfettered discretion to apply the income to any of the objects. In such instance, the whole trust would not be treated as charitable in nature. However, it has been held that when the primary object or dominant object satisfies the conditions of being charitable in nature then even if some ancillary or incidental objects are not charitable in nature the institution will still be considered as a charitable organisation, provided the charitable organisation continues to engaging in charitable activities only and desirably amends any such non-charitable clause.

## Religious Purpose

- 1.10.1** An NPO is treated as religious in nature when it is engaged in propagation of any particular faith or religion for public benefit. The term ‘charitable purpose’

is wide enough to include religious purpose as well. The Income Tax Act, 1961 in India does not define a religious organisation separately. It is implied that the scope of the term “charitable purpose” includes religious purpose. However, religious purpose cannot be pursued alongwith other charitable purpose. An organisation should be either religious or charitable in nature.

- 1.10.2** A religious charity is technically a charitable organisation, however, as discussed, it is expected that an organisation should be either religious or charitable. Though there might be overlap of religious and charitable activity; an organisation may be pre-dominantly charitable in nature though it may have some religious activity and vice versa.

## Private & Public Religious Purpose

- 1.11.1** An NPO is treated as religious in nature when it is engaged in propagation of any particular faith or religion for public benefit. However, if it confines its benefit to a particular community or group of people then it will be treated as a private religious organisation. On the other hand a religious organisation shall be treated as public religious organisation if it is engaged in propagation of any particular faith or religion for public benefit irrespective of caste, creed or religion. For example in a public religious temple or church people from any caste, creed or religion can come and worship.

## About Credibility Alliance

Credibility Alliance (CA) is a consortium of Voluntary Organizations committed towards enhancing Accountability and Transparency in the Voluntary Sector through good Governance. Registered in May 2004 as an independent, not-for-profit Organization, CA emerged as an initiative from within the Sector after an extensive consultative process over a period of two years involving thousands of VOs all over India. As an Organization, CA aspires to build trust among all stakeholders through improving Governance within the Voluntary Sector. As an initiative whose hallmark has been the participatory approach, CA has developed suitable Norms through wide-ranging consultation with and participation of diverse Organizations within the Sector by developing a large membership base.

With the mission 'to build credibility of the Voluntary Sector through creation and promotion of Norms of Good Governance and Public Disclosure', CA's core programme areas comprise of: Accreditation, Capacity Building, Networking and Information Dissemination.

- I. **Accreditation:** Accreditation of Voluntary Organizations refers to the certification of upholding of the quality of an organization, which adheres to the minimum norms or desirable norms set by Credibility Alliance. The main purpose of the Accreditation exercise is to develop a cost effective mechanism of periodic evaluation of VOs in the country.

'Minimum Norms' are the Norms that all VOs should follow. It is mandatory for all the Accredited Members of CA to comply with the Minimum Norms or give an undertaking that they will do so within an year, whereas 'Desirable Norms' are the next level of Norms for good Governance and public disclosure. These are the practices that are at present not mandatory and some Organizations may require time to adopt such practices.

- II. **Capacity Building:** Credibility Alliance focuses on the Capacity Building process to maximize its potential and sustain its work by adopting the existing best practices. CA plans the Capacity Building initiatives for the Voluntary Organizations by identifying and outlining the gaps in the Sector, assessing the needs and finally instituting the programs to address those needs.
- III. **Networking:** Credibility Alliance facilitates interaction between experts in different areas and promotes the sharing of ideas and information between the Voluntary Organizations and the experts. CA helps VOs to seek issue-based information in the Sector that they are working in, which helps in building the professional capacities of VOs through training, thereby enabling them to increase institutional capacities.
- IV. **Information Dissemination:** Credibility Alliance sensitizes, spreads awareness, assists, educates and appraises on the recent developments, responsibilities and other critical issues pertaining to Voluntary Sector by disseminating vital information periodically to all VOs.



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