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NGO

How to achieve financial independence

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NGOs receive their funding from donations, a lot of which cannot be applied immediately. As per tax laws, up to 15% of the income of an NGO can be accumulated for an indefinite period and form part of its corpus fund. Further, voluntary contributions can also form part of the corpus fund if the donor gives a specific direction to the effect. What is 'corpus fund'? It is the 'capital' of an NGO. It is the permanent fund available to an NGO that may be applied towards objective of the NGO or towards its daily running expenses such as salaries, rent of premises, etc.

Apart from the corpus fund, an NGO may also have voluntary contributions that are yet to be applied towards charitable or religious activities. An NGO can also choose to accumulate such voluntary contributions in accordance with the tax laws for a maximum period of 5 years to be applied in the future. During this period, such accumulated sum is required to be invested/deposited in the specified modes in order for the Income Tax exemption to continue.

Thus, the total of such surplus funds (corpus + accumulated income) may present an opportunity for an NGO to earn a significant return and create a self-sustaining model whereby the corpus itself gives a recurring annual return to the NGO. This way, an NGO can become less dependent on external donations for furthering its charitable objective.

What the Law says

Though there are various avenues where investments can be made, all are not available to NGOs availing exemption under the Income Tax Act, 1961 An NGO registered under section 12AA and/or 80G of the Income Tax Act, 1961 is only permitted to invest in the modes of investment prescribed under section 11(5) of the Act. If the accumulated income of an NGO ceases to remain invested or deposited in any of the prescribed modes, income tax exemption shall be withdrawn and its income shall become liable to tax.

Modes prescribed for investment by an NGO under section 11(5) of the Act:

1. Investment in immovable property to fulfill the objectives of the trust/Institution.
2. Investment in Government Securities and Government Saving Certificates and other Certificates issued by the Central Government under its Small Saving Scheme
3. Deposits with Post Office Savings Bank
4. Deposits with Scheduled Banks, Co-operative Banks, Industrial Development Bank of India (IDBI)
5. Investments in the units of Unit Trust of India (UTI)
6. Investment in **mutual fund** referred to in section 10(23D) of the Income tax Act, 1961. Section 10(23D) specifies the following mutual funds:
   - *Mutual Fund registered under SEBI Act, 1992 or regulation made there under*

- *Mutual Fund set up by a public sec tor bank or a public financial institution or authori zed by the Rese rve Bank of India*

7 Investment in any bonds issued by:

- *App roved financial co rpo ration providing long term finance for industrial development*
- *App roved public companies with objects providing long- term finance for construction or pu rchase of houses in India*
- *Public compa ny en gaged in long term finance for development of urban inf rastructu re*

8. Investment in any pu blic sec tor compa ny and debentu re of any Compa ny or Corpo ration (Principal and interest must be gua ran teed by the Cent ral or State Gove rnment)
9. Deposits made with an autho rity constitu ted in India for the pu rposes of housing accommodation, planning & development of citie s, towns and villages
10. Investment in equi ty sha res of a deposi tory

Despite so many investment options, generally NGOs invest their money in bank fixed deposits or other low risk investments mentioned under points 1 to 4 in the list above. This is due to two reasons: 1) Conservative approach (rightly so!) and 2) Lack of adequate information or guidance. Let us examine the common features of these investment options to understand why these investment options are popular.

Common features of the traditionally popular low risk investment options

Particula rs	Imm ovable prope rty	National Saving Certificates	Deposit with post office saving bank	Fixed deposits with scheduled/ other banks
Sa fety of capital	Usual ly yes	Yes	Yes	Yes
Liquidity	No	Yes but with financial penalty on ea rly withd rawal		
Average an nual return	3% (ren tal)	8%	8%	8%
Stability of return	Usual ly yes	Yes	Yes	Yes
Capital app reciation	Possi ble (if sold)	No	No	No

Thus, we can see that all the above investment options (except investment in immovable property) provide safety of capital and stable risk free returns. But liquidity comes with a financial penalty and the average annual return is 8% less tax withholding which can negatively affect cash flow.

Although 'low risk' is a good strategy for an NGO, the preferred investment options usually yield low returns, that too, which are liable to tax. **Wouldn't it be wonderful if**

NGOs could invest their surplus in an investment option that provides safety of capital with higher liquidity and better returns than a bank deposit? That's what this literature is aimed at! To provide you information about some investment options that can be very appropriate for NGOs keeping in mind the safety of their capital. After all, **an informed decision is a better decision**. So what other investment options are there that can combine safety of capital with high liquidity and better returns? Enter – 'Mutual Funds'.

Mutual funds

A mutual fund is a trust that pools money of various investors who share a common financial goal and then invests this money into financial assets (such as bonds, debentures, equity shares, etc) to meet the said goal. Mutual funds are regulated by SEBI and managed by financial and professional experts. These experts are able to achieve higher returns while maintaining low risk by pooling resources and diversifying investment.

Mutual funds can be of different types depending on the securities that they invest in. Accordingly, mutual funds can be equity oriented, (>65% equity), debt oriented (>65% debt securities) or everything in between. Since the primary consideration for any investment by an NGO is safety of capital, debt funds are best suited for them as they are extremely low risk investments.

Common features of debt funds

1. **Safety of capital**
2. **Low risk**
3. **High liquidity** (without financial penalty)
4. **Returns**
   a. Typically range between 8% - 9% (1% higher than fixed deposit rate)
   b. May be in the form of capital appreciation or distribution of dividends
5. **Lower taxation**
6. **Capital Appreciation**

Clearly, debt funds are a more lucrative investment option than bank deposits and other investment options mentioned above due to the following:

1. **Higher liquidity** (without financial penalty)
2. **Higher returns**
3. **Lower taxes on income**
4. **Possibility of capital appreciation**

Also, it important to choose the right kind of debt fund/ schemes depending on an NGOs need that can help achieve its financial goal. For example, an NGO wanting regular income for incurring its running expenses should opt for a Systematic Withdrawal Plan (SWP) while an NGO wanting to invest in a big project after 4 years should opt for a growth scheme so that its investment appreciates. Let us now understand the benefits of debt funds over other low risk investment options with the help of the following case study.

Case Study

An NGO has Rs. 1 crore as surplus funds. It requires Rs. 10 lacs to operate the NGO every year. NGO decides to invest the surplus sum in a low risk investment option that earns interest @ 10% p.a. that can be spent towards its running expenses. Let us consider two investment scenarios – bank fixed deposit and debt fund.

Scenario 1 – NGO invests the sum into a bank fixed deposit (assume rate of interest @ 10% p.a.)

- *The NGO at the end of year 1 earns Rs. 10 lacs*
- *However cash received by NGO is only Rs. 9 lacs after tax withholding @ 10%*
- *As per tax laws, NGO needs to apply 85% of this earning towards its charitable objective. Thus, NGO needs to apply Rs. 8.50 lacs out of the Rs.9 lacs received in order for this income to be exempt from tax*
- *But it also needs this money to keep the NGO running – **This is misalignment of investment with financial objective***

Scenario 2 – NGO invests the sum into a debt fund (let us assume same rate of return i.e. 10% p.a.)

- *The NGO at the end of year 1 earns Rs. 10 lacs*
- *NGO can opt for a SWP so that Rs. 84,000 is withdrawn every month for running expenses (**no tax withholding**). By the end of the year, the NGO would have received Rs. 10 lacs as required*
- *As per tax laws, NGO needs to apply 85% of its earning towards its charitable objective. However, the entire sum of Rs. 10 lacs is not considered its income. The income part of Rs. 10 lacs (calculated pro rata to its capital) amounts to Rs. 90,909 only (i.e. Rs. 10 lacs* 10 lacs/110 crore)*
- *Thus, NGO needs to spend only Rs. 90,909 out of the Rs. 10 lacs received for the entire sum to tax exempt*
- *This leaves the NGO with adequate funds to operate the NGO for the year – **Investment aligned with financial objective***

Conclusion

Investing in mutual funds is beneficial not just because it provides better returns or higher liquidity but from many other standpoints as illustrated by case study above. And not only this, there are many other benefits that can ensue when your **investments are aligned with your financial goals**. If you would like to know more about investment in mutual funds, feel free to get in touch with us. We would be happy to schedule a meeting with you.

Compiled By:
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to create effective and useful awareness.

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