Application of Income of Registered Non-Profit Organisations (RNPOs) under the Income Tax Act, 2025

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(Sections 341–343, Income Tax Act, 2025 — Part B of Chapter XVII: Special Provisions for Registered Non-Profit Organisations)

> **Note:** As part of the transition to the Income Tax Act, 2025, the concepts of "previous year" and "assessment year" have been replaced with a single concept of a "tax year". Throughout the series, "tax year" refers to the financial year beginning on 1 April and ending on 31 March.

Introduction

This is the third issue in a seven-part series explaining how the Income Tax Act, 2025 ("the Act") taxes registered non-profit organisations (RNPOs).

In the last issue, *Classification of Income of Registered Non-profit Organisations (RNPOs) under the Income Tax Act, 2025*, we discussed that an RNPO must spend 85% of its regular income towards its registered charitable or religious purpose or accumulated/set apart in accordance with Section 342 of the Act.

This issue focuses on the application of income provisions contained primarily in Section 341 to Section 343 of the Income Tax Act, 2025. **These provisions determine what expenditure qualifies towards the statutory application requirement and what does not.** It covers what qualifies as application of income (85%), when an RNPO may formally accumulate income for future application, and the treatment of the automatic 15% retention of regular income.

There are three main modes of application of income:

1. Application of income towards registered charitable or religious purposes under Section 341
2. Accumulation of income under Section 342
3. Deemed accumulated income under Section 343

1. Application of Income Towards Registered Charitable or Religious Purposes (Section 341)

The thumb rule is that the RNPO must spend at least 85% of its regular income towards its registered charitable or religious purpose. However, merely spending money on charitable or religious purposes is not sufficient to satisfy the 85% application requirement. The spending must also comply with the RNPO's other obligations under the Act, as detailed below.

TDS Compliance

i) If an RNPO makes a payment to a resident on which tax has to be deducted at source, and that tax was not deducted, or was deducted but not deposited with the government by the due date (of filing returns of the RNPO's income), then 30% of such TDS non-compliant payment does not count as application of income and only the remaining 70% counts towards the RNPO's 85% requirement, even if the full amount was actually spent.

ii) This disallowance is not necessarily permanent: If the RNPO subsequently deducts and deposits the tax, even in a later tax year, the 30% that was earlier disallowed becomes allowable as application of income in the year such tax is actually paid. Further, if the **payee (recipient) has included the relevant income in their own return and paid tax on it**, no disallowance is made in the hands of the RNPO — even if the RNPO failed to deduct TDS.

Illustration 1

Context: An RNPO received ₹50 lakh as regular income, out of which ₹48 lakh was applied as per the provisions of the Act. However, out of the ₹48 lakh, the RNPO fails to deduct and deposit tax at source on the payment of ₹5 lakh to a legal consultant.

Step 1: Tax liability on the ₹5 lakh payment = 10% of ₹5 lakh = ₹50,000, which the RNPO should have deducted and deposited but did not.

Step 2: Amount treated as non-application of regular income due to this TDS non-compliance = 30% of ₹5 lakh = ₹1.5 lakh. The remaining 70%, i.e., ₹3.5 lakh, continues to count towards the RNPO's application of income for that tax year.

Result: If in a subsequent tax year, the RNPO deducts and deposits the ₹50,000 tax, the ₹1.5 lakh that was earlier disallowed becomes allowable as application of income in that later year.

Restrictions on Cash Payments

i) Any payment or aggregate of payments made to a single person on a single day, exceeding ₹10,000 made via cash and not through specified banking or online mode, shall not be considered as an application of regular income.

Note: In case the payment is specifically made for plying, hiring or leasing of goods carriages, then the cash payment threshold is ₹35,000 instead of ₹10,000.

ii) For an RNPO maintaining books on accrual basis, if an expenditure was recognised in an earlier tax year and considered as application of income, but the actual payment exceeding ₹10,000 is made in a subsequent tax year, in cash, then that payment becomes income in the year of payment in the hands of the RNPO.

iii) The above restriction is not absolute. The Act permits exceptions in specific cases and circumstances, having regard to factors such as the extent of banking facilities available in the area and considerations of business expediency. These prescribed exceptions are not yet detailed in the Act.

Donation to Other RNPOs

If an RNPO donates any amount to other RNPOs out of its regular income, then only 85% of the donated amount will be considered towards application of income.

Deferred Application: Corpus and Loan Funded Spending

Certain expenditure qualifies as an application of income when the spend occurred in an earlier tax year(s) but was not allowed as an application in that year.

Spending Made from RNPO's Corpus Funds

If an RNPO temporarily utilises its corpus fund to finance expenditure after 31 March 2021, that would ordinarily have been met from its regular income, such expenditure would be considered as an application of income when the following conditions are met:

i) Such expenditure would be considered as an application of income in the tax year in which the RNPO restores the amount spent back into corpus as per approved modes under Section 350 of the Act (covered in the later issue); and

ii) Such investment or depositing back is made within five years from the end of the tax year in which such application of income was made from the corpus; and

iii) There was no violation of any provision of the Income Tax Act, 1961 with respect to such application.

Exception: The above does not apply if the RNPO temporarily used corpus funds for a purpose inconsistent with the specific directions of the donor. Such use will never be recognised as application of income.

Spending Made by RNPO from Borrowed Funds

The amount repaid during the tax year towards any loan or borrowing is treated as an application of income where:

i) The borrowing was made by an RNPO, and repayment is made within five years from the end of the tax year in which the application of income was made from the loan or borrowing; and

ii) The application of income from the loan or borrowing was made after 31 March 2021, and there was no violation of any provision of this Part, or any corresponding provision of the Income Tax Act, 1961, with respect to such application.

Illustration 2

Context: In the tax year 2027, an RNPO receives ₹40 lakh as regular income but needs an additional ₹15 lakh to construct a training centre for its beneficiaries. As it has not yet received an expected grant, it borrows ₹15 lakh from a bank and completes the construction, spending the entire ₹55 lakh (₹40 lakh regular income + ₹15 lakh borrowed funds) in the same tax year.

Step 1: Of the ₹55 lakh spent, ₹40 lakh is considered application of income in that tax year. The remaining ₹15 lakh, spent out of borrowed funds, is not treated as application of income in that year.

Result: In the tax year 2029, after receiving the grant, the RNPO repays the entire ₹15 lakh loan from its own funds, and not by further borrowing. This ₹15 lakh repayment is treated as application of income in the tax year 2029, since the loan is repaid within five years from the end of the tax year in which the borrowed money was used, the original expenditure was incurred after 31 March 2021, and the original expenditure complied with the provisions governing RNPOs.

What Expenditure Cannot Be Considered as an Application of Income

1. Depreciation on assets where the asset acquisition has been claimed as an application of income in current or previous tax years.
2. If an RNPO applies more income towards its charitable or religious purposes than the regular income available during a tax year, the excess application cannot be carried forward and claimed as application of income in a subsequent tax year.

3. Any sum paid as a corpus donation to another registered non-profit organisation is not treated as application of income at all. This is different from a donation made out of regular income to another RNPO, where 85% of the amount counts as application (see "Donation to Other RNPOs" above).

Deemed Application of Income

Treatment of Shortfall in the 85% Requirement

Where an RNPO applies less than 85% of its regular income towards charitable or religious purposes in a tax year, it is not automatically treated as a shortfall. Instead, the RNPO may elect to treat this shortfall, or any part of it, as "deemed application" provided it is applied within a specified window in a future year.

To exercise this option, the RNPO must:

a. File Form 108 on or before the due date for filing its return of income for that tax year; and

b. Actually apply the shortfall amount within the following timeline:

i. If the shortfall arose because part or all of the income was not yet received during the tax year, by the end of the tax year in which the income is received, or the tax year immediately after; or

ii. If the shortfall arose for any other reason, by the tax year immediately succeeding the year in which the income was derived.

c. Once applied within this window, the amount is treated as regular application of income under Section 341(1).

Note: "Deemed application" is distinct from "deemed accumulated income". Deemed application is an elected, time-bound mechanism requiring a formal filing, used to cure a shortfall in the 85% requirement. Deemed accumulated income is an automatic retention of up to 15% of regular income that requires no filing or election.

Capital Gains Reinvestment as Deemed Application

Where an RNPO sells a capital asset that was held wholly or partly for charitable or religious purposes and reinvests the proceeds into acquiring another capital asset for the same purpose, the capital gain (if any) earned and invested may be treated as deemed application of income.

The RNPO does not need to separately apply an amount equivalent to the capital gain towards its charitable objects to meet the 85% requirement. The extent to which the capital gain is treated as deemed application depends on how much of the sale proceeds ("net consideration") were reinvested:

a. **Asset held wholly for charitable purposes:** If the entire net consideration is reinvested in the new asset, the whole capital gain is deemed application. If only part of the net consideration is reinvested, only the portion of the gain equal to the amount by which the reinvestment exceeds the cost of the asset sold is deemed application.

b. **Asset held partly for charitable purposes:** The same treatment applies, but only to the "appropriate fraction" of the gain — the fraction representing the extent to which income from the asset was applied to charitable purposes immediately before the sale.

Illustration 3

Context: An RNPO sells a property held wholly for its charitable purposes for ₹80 lakh (net consideration), realising a capital gain of ₹30 lakh (the property's cost of acquisition was ₹50 lakh).

Scenario 1 (full reinvestment): The RNPO reinvests the entire ₹80 lakh net consideration into a new property for the same purpose. Since the whole net consideration was reinvested, the entire ₹30 lakh capital gain is deemed application of income; the RNPO need not separately apply this amount to satisfy the 85% requirement.

Scenario 2 (partial reinvestment): The RNPO reinvests only ₹65 lakh of the ₹80 lakh net consideration. The deemed application is limited to ₹15 lakh — the amount by which the ₹65 lakh reinvested exceeds the ₹50 lakh cost of the asset sold. The remaining capital gain of ₹15 lakh (₹30 lakh − ₹15 lakh) must be separately applied or accumulated to count towards the 85% requirement, like any other regular income.

Result: Full reinvestment shields the entire ₹30 lakh gain from the 85% requirement; partial reinvestment shields only ₹15 lakh, leaving the remaining ₹15 lakh subject to the ordinary application/accumulation rules.

2. Accumulation of Income (Section 342)

Section 342 offers the second mode of application of income: accumulating or setting apart income for future application.

When and How an RNPO May Accumulate Regular Income

In any tax year, an RNPO may accumulate or set apart any part of its regular income for a maximum of **five years** by following the process below:

- File Form 109 before the due date for filing its return of income;
- Specify the purpose for which income is being accumulated; and
- Specify **the duration for which accumulation is done** (maximum of **five years**).

Restrictions on Accumulated Income

i) Any amount accumulated or set apart shall not be transferred by an RNPO to another RNPO. If such a transfer happens, it will not be considered as application of income; instead, the transferred amount is treated as specified income under Section 337 and taxed at a flat 30% in the tax year in which it is so credited or paid.

ii) If accumulated income is applied for a purpose other than as originally specified, or is not applied within the five-year window, it is treated as specified income under Section 337 and taxed at a flat 30% in the year of breach.

Illustration 4

Context: In Tax Year 2027, an RNPO is unable to apply 85% of its regular income and therefore accumulates ₹20 lakh for constructing a vocational training centre, by furnishing the prescribed statement to the Assessing Officer.

Scenario 1 (RNPO applies the funds itself): In Tax Year 2029, the RNPO uses the accumulated ₹20 lakh to construct the vocational training centre, as originally specified. This amount is treated as application of income under the Act.

Scenario 2 (RNPO transfers the funds to another RNPO): In Tax Year 2029, instead of using the accumulated funds for the stated purpose, the RNPO donates the ₹20 lakh to another RNPO.

This transfer is not treated as application of income, since accumulated income cannot be applied by transferring it to another RNPO.

Result: Only Scenario 1 satisfies the accumulation requirement. In Scenario 2, since the accumulated income was neither applied for its stated purpose nor applied at all (having instead been transferred to another RNPO), it will be treated as specified income and taxed at a flat 30% in the year of donation made to another RNPO.

3. Deemed Accumulated Income (Section 343)

An RNPO may automatically retain up to 15% of its regular income each year, in addition to the application of regular income and accumulated income under Section 342. This amount is known as deemed accumulated income and does not require the RNPO to furnish a separate statement or specify a purpose.

Deemed accumulated income = regular income − application under Section 341 − formal accumulation under Section 342 (subject to a maximum of 15% of regular income).

If the amount is retained, it must be invested in the approved modes (discussed in later editions). Any investment made in contravention of the permitted modes will be classified as specified income and taxed at a rate of 30%. This automatic accumulation is separate from, and does not form part of, the accumulation permitted under Section 342.

Application of deemed accumulated income in a later year is not treated as application of income because Section 341 (application of income) specifically excludes application out of deemed accumulated income from being counted as application in that later year.

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