

Violations, Registration Cancellation, and Tax Consequences for RNPOs

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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 sixth issue in a seven-part series explaining how the Income Tax Act, 2025 ("the Act") taxes Registered Non-Profit Organisations ("RNPOs").

In the previous issue, [*Compliance Requirements Applicable to an RNPO*](#), we explored the key obligations an RNPO must fulfil to maintain its tax exemption, including maintaining books of account, getting them audited, filing the return of income, and investing funds only in permitted modes.

This issue examines what happens when an RNPO fails to comply with its obligations under the Income Tax Act, 2025, breaches conditions attached to its registration or exemption, or otherwise ceases to qualify for the tax-exempt regime.

Tax Consequences for RNPOs

The Act provides for different consequences depending on the nature of the violation or event:

- **Consequence 1: Specified violations and Cancellations of Registration:** Certain lapses that can lead to cancellation of an RNPO's registration altogether, and can trigger a one-time exit tax on the RNPO's accumulated assets.
- **Consequence 2: Other Violations — Loss of Exemption Without Cancellation:** Narrower, more procedural lapses (such as not maintaining books, not getting audited, or not filing a return) that cause the RNPO to lose exemption for that specific tax year, without necessarily cancelling its registration.
- **Consequence 3: Tax on accreted income:** In specified circumstances where an RNPO's registration or exempt status ceases or changes including cancellation, certain changes to its objects, conversion, merger or dissolution, the RNPO may also become liable to additional tax on its accreted income, broadly reflecting the value of assets accumulated during the period of exemption.

Consequence 1: Specified Violations and Cancellation of RNPO Registration

What Counts as a "Specified Violation"?

Following are the closed list of situations that amount to a specified violation as per Section 351 of the Income Tax Act 2025.

- **Misapplication of income:** Any income of the RNPO has been applied for purposes other than its stated objects. (*Refer “Note 1”*)
- **Unauthorised commercial activity:** The RNPO (other than an RNPO carrying out advancement of any other object of general public utility) carries out a commercial activity that is not ancillary to the attainment of its objectives and does not maintain separate books of accounts for such activities (Section 345).
- **Private religious application:** Any part of the RNPO's total income which has been applied for private religious purposes that do not benefit the public at large.
- **Benefit to a particular religious community or caste:** An RNPO set up for a charitable purpose *after* the Act commenced applies income for the benefit of a specific religious community or caste (other than Scheduled Castes, Scheduled Tribes, backward classes, women, or children).
- **Activities not genuine, or not run as registered:** The RNPO's activities are not genuine, or are not carried out in line with the conditions on which it was registered. (*Refer “Note 1”*)
- **Non-compliance with other laws:** The RNPO has failed to comply with a requirement under any other law referred to in Section 332(7)(a), and this failure has either not been disputed or has become final.
- **False information at the time of registration:** The RNPO's original registration application contained false or incorrect information.

“ **Note 1: Distinguishing “Misapplication of Income” from “Non-Genuine Activity”** ”

These may appear similar in practice, but they address different forms of non-compliance.

- **Misapplication of Income: Income applied other than for the RNPO's objects:** This concerns how the RNPO uses its income. The RNPO and its activities may be genuine, but a particular expenditure may fall outside its stated objects. The key question is whether the income has been applied for a permitted purpose. For example, where an RNPO incurs expenditure on a programme that does not fall within

its stated charitable objectives, the issue is the application of income. Evidence such as expenditure records and the connection between the expenditure and the RNPO's objects would be relevant.

- **Non Genuine Activity: Activity not genuine, or registration conditions not complied with:** This concerns what the RNPO actually does and whether it complies with the conditions of its registration. It may arise where a reported activity is not genuinely carried out, or where the organisation operates in breach of a registration condition. For example, expenditure may appear to relate to a charitable programme on paper, while the underlying programme is not actually being carried out. In such cases, evidence of the actual activities undertaken and compliance with the registration conditions would be relevant.

The key takeaway is that an RNPO responding to a show-cause notice should identify the specific nature of the alleged violation and address it directly using corresponding evidence.

How is a Specified Violation Established?

A specified violation isn't self-declared but is established through a formal process initiated by the Principal Commissioner or Commissioner (PCIT/CIT):

1. **Trigger:** The PCIT/CIT notices a possible violation during any tax year, receives a reference from the Assessing Officer, or the RNPO is selected under the risk management strategy of the board.
2. **Inquiry:** The PCIT/CIT calls for documents or information from the RNPO, or makes any inquiry considered necessary.
3. **Order:** After giving the RNPO a reasonable opportunity to be heard, the PCIT/CIT either:

- **Cancels** the registration, for that tax year and all subsequent tax years, if satisfied that a specified violation has occurred; or
 - **Does not cancel** the registration, if not satisfied that a violation has occurred.
4. **Timeline:** This order must be passed within six months from the end of the quarter in which the first notice calling for documents, information, or inquiry was issued.
 5. **Communication:** A copy of the order is sent to both the Assessing Officer and the RNPO.

What Happens Once a Specified Violation is Established?

If an order of cancellation of registration is passed by the PCIT/CIT, this triggers further tax consequences for the RNPO as follows:

- **Loss of exemption for the RNPO's entire income:** If registration is cancelled, the RNPO's income for the tax year in which the violation occurred, and all subsequent tax years, ceases to be eligible for exemption. The RNPO's income is then taxed in full, as ordinary income, and not merely the portion connected to the violation. (Refer "Note 2")
- **Possible additional tax on accreted income:** Tax on accreted income is a one-time, additional levy on the RNPO's net assets at the maximum marginal rate. (Covered in detail under "Tax on accreted income" later in this issue.)

“ Note 2: Consequences of Cancellation

- **No automatic revival of exempt status:** Cancellation does not reverse itself with time or with subsequent compliance. To regain exempt status, the RNPO would need to apply afresh for registration under Section 332. (Refer Issue 1: [Registration of Non-Profit Organisations under the Income Tax Act, 2025](#)).
- **Right of appeal:** A cancellation order is an appealable order under section 362 of the act. If, after inquiry and giving the RNPO an opportunity to be heard, the PCIT/CIT is satisfied that a specified

violation has occurred, the section provides for cancellation of the RNPO's registration. The tax consequences, such as loss of exemption and, where applicable, tax on accreted income, follow from the cancellation.

Consequence 2: Other Violations — Loss of Exemption Without Cancellation

The other violations deal with a narrower set of lapses that do not, by themselves, put the RNPO's registration at risk, but do result in the RNPO losing its exemption for the tax year in which the lapse occurs.

These "other violations" are:

- **Failure to maintain books of account**
- **Failure to get the accounts audited**
- **Failure to furnish a return of income**
- **Unauthorised commercial activity** carried out under the "advancement of any other object of general public utility" head.

How is an “Other Violation” Established?

- There is no separate show-cause process for “other violations”. Where an RNPO has failed to maintain its books, failed to obtain the required audit, failed to furnish its return of income, or exceeded the applicable commercial-activity threshold, the following statutory consequence can apply for that tax year.

What Happens When an “Other Violation” Occurs?

The consequence is narrower than cancellation of registration and is generally confined to the tax year in which the default occurs.

- **Exemption is lost for that tax year:** For the relevant tax year, the RNPO’s otherwise exempt income is brought to tax after allowing only the expenditure that satisfies the conditions prescribed under the Act. The resulting income is taxable at the rate applicable under Section 334.
- The regular income for that tax year becomes taxable income, after reducing it by the expenditure that meets the following conditions:
 - The expenditure must be incurred in India;
 - The expenditure must be applied towards the RNPO’s own objects;
 - The expenditure must be incurred out of current income, rather than corpus or borrowed funds;
 - The expenditure should not represent depreciation that has already been claimed in another manner;
 - The expenditure should not constitute a donation or application passed on to another person;
 - The expenditure must comply with restrictions relating to payments to specified persons; and
 - The expenditure otherwise satisfies the requirements for allowable application under the Act.
 - No additional deduction, loss or set-off is available beyond what the Act specifically permits for this purpose.
- **Other taxable income remains taxable:** Specified income and other income that is independently taxable under the Act continue to be taxed according to the provisions applicable to those income streams.

“ **Note 3: Implications of Repeated Non-Compliance**

Repeated or serious compliance failures, particularly failures relating to books, audit, returns or the limits on commercial activity may invite greater scrutiny. Such scrutiny could, depending on the facts, reveal a separate specified violation, such as non-genuine activities or misapplication of income. That would bring the RNPO within the more serious cancellation framework.

Loss of exemption status whether under a “specified violation” or “other violation” would have implications for the RNPOs donors and it is prudent to immediately convey the change in status to them.

Consequence 3: Tax on accreted income

When an RNPO's registration is cancelled, it loses its tax-exempt status. In addition to tax on its regular income, the RNPO may also be liable to pay an additional tax on its accreted income, also known as exit tax.

The exit tax trigger is not limited to cancellation of registration. It can also get triggered in certain other specified circumstances, such as certain changes to the RNPO's objects, failure to make a required registration application, certain mergers and dissolution.

The following explains what accreted income means, when the tax applies, and how the tax is computed.

What is Accreted Income?

Accreted income broadly represents the value of the assets accumulated by the RNPO, after taking into account its liabilities. The value of the assets and liabilities is determined as on the relevant date specified under the Act and using the prescribed valuation method. The value of specified assets and the liabilities related to them is then excluded from the calculation.

It is calculated as:

Accreted income chargeable to tax = (Fair market value of total assets – Total liabilities) – Amount attributable to specified assets and related liabilities

“ **Note 4: What are Specified Assets?**

For the purpose of calculating accreted income, a specified asset is an asset that was acquired by the RNPO in one of the following circumstances specifically identified by the Act:

- 1. Assets acquired directly out of agricultural income referred to in Schedule II of the Act.
- 2. Assets acquired between the RNPO's establishment and the effective date of its registration, where the RNPO did not receive the relevant tax benefits during that period and its registration is not given retrospective effect under the applicable provisions.
- 3. Assets acquired between the RNPO's establishment and the effective date of its registration are also treated as specified assets, including where the registration subsequently becomes effective retrospectively under the specified provisions of the Income Tax Act, 1961.
- 4. Assets transferred to another specified person within the prescribed period following dissolution - within twelve months from the end of the month in which dissolution takes place.

Situations in Which Tax on Accreted Income Applies

The circumstances in which an RNPO becomes liable to pay tax on accreted income includes:

Situation	Specified date for calculating tax liability
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Registration cancelled and the RNPO appeals	Date when the cancellation order becomes final
Registration cancelled and the RNPO does <i>not</i> appeal	Date of the cancellation order
RNPO modifies its objects so they no longer conform to its registration conditions, and does not seek fresh registration or the RNPO seeks fresh registration, which is rejected and appealed or no appeal is filed against the rejection	Date when the objects are modified
RNPO fails to apply for registration within the prescribed period (including under transitional provisions)	The date such application ought to have been made
RNPO converts into a form not eligible for registration	Date of conversion
RNPO merges with an entity that is not an RNPO, or with an RNPO that does not have the same or similar objects	Date of merger
RNPO dissolves and fails to transfer all its assets to another RNPO within 12 months of dissolution	Date of dissolution

In each case, the due date for payment is pegged to when the cancellation or rejection becomes final, for instance, on expiry of the appeal period, or on receipt of an appellate order confirming cancellation.

What is the Rate of Tax on Accreted Income?

Tax on accreted income is charged at the maximum marginal rate. This tax is payable in addition to any income tax otherwise chargeable on the RNPO's total income.

When does the Tax have to be Paid?

The specified person and its principal officer or trustee are responsible for paying the tax on accreted income to the Central Government within fourteen days from the relevant due date specified for the applicable trigger event.

What Happens if the Tax is not Paid on Time?

If the tax on accreted income is not paid within the prescribed period, simple interest at 1% per month or part of a month is payable on the unpaid tax until it is actually paid.

Is this Tax Treated as a Final Tax?

Yes. Tax paid on accreted income is treated as the final payment of tax in respect of that accreted income.

Conclusion

The Act provides for different consequences depending on the nature of the non-compliance. As discussed above some violations may result in loss of tax exemption for a particular year, and specified violations can lead to cancellation of registration. In certain situations, cancellation or other changes in an RNPO's status can also trigger tax on accreted income, which is an additional tax on the RNPO's accumulated assets, subject to the rules under Section 352.

For RNPOs, the key takeaway is that maintaining tax-exempt status requires continued compliance with the conditions of the Act and not merely obtaining registration in the first place.

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