Taxation of Charitable Institutions: Key Amendments in Last 7 years at Glance

Finance Act	Amendments
2016	115TD - Exit tax on accreted income w.e.f. 01.06.2016
2017	Mandatory re-registration upon modification in objects w.e.f. 01.04.2018
	Filing of ROI within due date as per section 139(4A) for claiming exemption w.e.f. 01.04.2018
	Restriction on Corpus donation w.e.f. 01.04.2018
	Cash Donations more than Rs. 2000 not eligible for 80G deduction w.e.f. 01.04.2018 (Earlier the said limit was Rs. 10,000)
2018	Applicability of section 40(a)(ia) & 40A(3) w.e.f. 01.04.2019
2020	Re-registration/New Registration scheme applicable w.e.f. 01.04.2021 - u/s10(23C), 12AB, 80G
	If the Institution gets approval under section 10(23C) or 10(46), the registration granted under section 12AA becomes inoperative, w.e.f. 01.06.2020.
	New Compliance in form of filing annual return for donations received u/s 80G w.e.f. 01.04.2021 (section 80G(5)(viii), Rule 18AB) – Form 10BD
2021	Application out of corpus not treated as application of income w.e.f. 01.04.2021.
	Repayment of Loan to be treated as application of income w.e.f. 01.04.2021.
	No carry forward and set off of excess application w.e.f. 01.04.2021.
	Corpus Donations to be invested in section 11(5) modes to claim exemption w.e.f. 01.04.2021.
2022	Application of income will be treated only if "Actually paid"
	Maintenance of books of accounts
	New Section – 271AAE – Penalty linked with the benefits to 13(3) persons
	New Section – 115BBI – Special tax rate for specified income
	Computation of income in cases of denial of exemptions (such as no audit carried out, no ITR filed, commercial receipts >20% of total receipts)
	Voluntary Contributions for the renovation and repair of Temples, Mosques, Gurudwaras, Churches, etc.
	Provisions for accumulation streamlined
	Taxability of Unreasonable benefit
	Section 115TD – Tax on accreted income
	Filing of ITR to claim exemption

Regime 1: Entity approved under section 10(23C)	Regime 2: Entity registered under section 12AB

Study Material: Relevant in current scenario applicable on Charitable Institution

Topic 1: Amendments inserted via Finance Act, 2022

➢ **Amendments inserted under both the regimes**

1. Maintenance of books of accounts:

Where the total income of the trust or institution, under both the regimes, exceeds the maximum amount which is not chargeable to tax which is Rs.2,50,000, such trust or institution shall keep and maintain such books of accounts and other documents as notified by CBDT under Rule 17AA, notification no. 94/2022 dated 10.08.2022

But what is the requirement of such provision?

Earlier, when no such provision was there, the same type of trusts who are registered under the same section used to maintain different types of books of accounts as per their convenience.

- All this was leading to high complexity for the AO to examine the books of accounts.
- This change is effective from P.Y. 2022 -23.

2. Section 271AAE

Where any trust/institution passes on unreasonable benefit to the trustee or any other specified person u/s 13(3), it shall be liable to pay the penalty which is as follows:

First time Violation	•Penalty of a sum equal to 100% of amount applied for benefit of such person
Subsequent Violation	•Penalty of a sum equal to 200% of amount applied for benefit of such person

- This change is effective from P.Y. 2022 -23.

3. **New tax rate prescribed for specified incomes - Section 115BBI**

Earlier, where trust makes any violation with the condition to avail exemption, such as accumulation of funds for prohibited purposes, partial application of accumulated funds, deployment of funds in prohibited investments, and diversion of income/provision of excessive benefits to trustees/other specified persons, the registration and complete exemption of the trust was at stake.

In order to avoid undue hardships, concept of **specified income** has been introduced. Specified income means the quantum of amount involved in the different types of violation as mentioned above.

As per Finance Act 2022, such specified income is liable to tax at a **flat rate of 30 percent** under section 115BBI (plus applicable surcharge if any and cess) **without reduction of any expenditure or allowances or set off of losses.**

Normal provisions will apply to income other than above, to avail income tax exemption subject to terms and conditions as prescribed u/s 11.

This change is effective from P.Y. 2022 -23.

4. Computation of taxable income resulting on account of certain prescribed non-compliances

Earlier, there was no explicit provision determining the manner of computation of taxable income resulting on account of non-compliance.

Now, the taxable income resulting on account of prescribed non-compliances (such as not maintaining prescribed books of accounts, not filing the Return of Income, and carrying on commercial activities for consideration beyond the prescribed threshold) shall be computed **after allowing deduction of revenue expenditure** incurred in India, but subject to the following conditions:

- Expenditure should not **be** a donation or contribution to any person.
- Non compliance of Section 40(A)(3) and 40(a)(ia).
- Expenditure incurred from the corpus or any loan or borrowing shall not be allowed.
- Depreciation on an asset, the cost of which is claimed as an application of income in any year, shall not be allowed.

This change is effective from P.Y. 2022 -23.

5. Voluntary contribution for the renovation and repair of Temples, Mosques, Gurudwaras, Churches, etc notified under clause (b) of sub section (2) of section 80G

As per this amendment, if any voluntary contribution is received by the temples, mosques, etc., for the renovation and repair, then it is **at the option of trust and institutions** (as per explanation 3A in section 11), **to treat it as corpus donation** or not. However, for treating it as a corpus donation, certain **conditions** have to be fulfilled:

1. Applies such corpus amount for the purpose for which such contribution is received.
2. Not to apply such an amount for making a contribution or donation to any person.
3. Such corpus amount should be separately identifiable in books of accounts.
4. The corpus amount has to be invested in modes specified under section 11(5).

- If any of the above conditions are violated, such corpus amount shall be included in the income of that P.Y.
- This change is effective from P.Y. 2020 -21.

➢ **Amendments for streamlining the provisions of both the regimes**

1. **Period of utilization of accumulation**

A trust/institution is required to apply at least 85% of its income towards charitable activities in a particular year. However, in the event this threshold is not met, the law allows for the accumulation of funds to be applied for charitable purposes in future years (not exceeding 5 years), subject to certain conditions.

- Earlier, such accumulated funds can be applied even in the year subsequent to the P.Y. of accumulation i.e in the 6th Year even if it is not used at the end of the 5th Year.
- **As per *the new provision, now unutilized income will be treated as income of such trust or institutions in the 5th year only in both regimes.***
- This change is effective from P.Y. 2022 -23.
- Further, conditions for accumulation for 5 years through filing of Form 10 which was earlier covered under Regime 2, are also applicable in respect of trusts governed under the specified institutions' regime as well i.e. Regime 1.

2. **Taxability of unreasonable benefit**

Earlier under regime 2, trusts or institutions are not required to pass on any benefit (unreasonable) specified under section 13(2) to any person specified under section 13(3), otherwise the same will be taxable in the hands of trust and will not be considered as application of income.

Therefore, to bridge the gap, **"twenty-first proviso in clause (23C) of section 10 of the Act"** is inserted according to which:

If any income has been applied for the benefit of any person specified in section 13(3) then such income shall be deemed to be the income of trust or institutions approved under regime 1 in the P.Y. in which it is applied.

3. **SECTION 115TD**

This section basically is referred to the Exit tax for the trusts or institutions.

Any trust or institution carrying on any charitable activity may voluntarily wind up its activities and dissolve or may also merge with any other charitable or non-charitable institution, or it may convert into a non-charitable organization.

But what is the need for such provision?

A specific provision in the Act was brought about for imposing a levy like an exit tax to ensure that the intended ***purpose of exemption availed by trust or institution is achieved***.

- The said provision is already present in regime 2 so the provisions are amended to make the above provision applicable in regime 1 also.
- Tax @42.744% (inclusive of surcharge and cess) will be applicable as exit tax for trusts or institutions. The same is calculated on difference of Market Value of Assets and Book Value of Liability.

4. **Filing of ITR within due date to claim exemption**

Filing of ITR within stipulated time was made compulsory under regime 2 for trusts or institutions to claim exemptions but there was no such provision in the case of regime 1.

As per the amendment, to claim tax benefit under regime 1, filing of ITR within stipulated time has been made compulsory.

In the recent Era, return form has been changed drastically as now detailed feeding of balance sheet items, loans, borrowings, corpus fund and their utilization is required.

The return form has been designed in such a way that each detail can be extracted from a single form.

Are there any gaps still left between both theses regimes?

No, there is one of the most important gap which still exists in Regime 1 and Regime 2, which is with respect to deemed application of income. This exists as a loophole between 12A and 10(23C) and probably the Finance Act 2023 will be able to bridge this gap between these 2 sections and helps to

avoid undue hardships which are currently faced by trust/ institutions approved under regime 1.

•DEEMED APPLICATION OF INCOME

Where the whole or any part of the income has not been received during the year, the assessee has the option to apply such income for such purposes during the P.Y. in which it is received or during the P.Y. immediately following the said P.Y.

But where the assessee fails to apply the whole or any part of the income received during the P.Y. in which it is received, the assessee has the option to apply such income for such purposes during the P.Y. immediately following the P.Y. in which the income was derived.

This option can be exercised by the trust registered under regime 2 by furnishing Form 9A to the AO under section 11(1). This option is still not present under regime 1 which creates a gap between the two.

• ELIGIBILITY TO OBTAIN CSR FUNDS

Earlier, institutions undertake registration under both the sections i.e. 12A as well as 10(23C) and take CSR benefits through 12A Section. However, as a result of the amendment brought through the Finance Act 2020, a trust/institution has to opt for either 12A or 10(23C). This act is an undue hardship to the genuine trust having registration u/s 10(23C) and also it significantly defeats the very purpose of CSR law specifically due to the following two core reasons:

1. The unfortunate exclusion of 10(23C) approved trusts/ Institutions may curtail or defeat the very purpose of this registration requirement, to a significant extent.
2. If 10(23C) registered Institutions wish to do CSR activities by obtaining CSR funds, they would be forced to forego 10(23C) approval and will have to apply for fresh registration u/s 12AB, which will be provided after detail enquiry, scrutinize and verification of various data, information etc. by the respective authority of income tax.

Roadmap to ensure Compliance:

- Trusts should shift their vision and working style from manual to automation for smooth working.
- Trust should educate and train its staff for effective compliance
- Trust needs to employ experience person or professional so as to ensure compliance of trust laws, which has been amended drastically in last few years
- Proper Fixed asset registers and prescribed books of accounts should be maintained.

Topic 2: Charitable Trust - Managing Application of Income on Actual Payment Basis

The CIs have to apply 85% of their income towards charitable objectives, however before the introduction of the Finance Act, 2022; there was no specific condition in the law that this application of income has to be calculated on an accrual basis or actually paid basis. It was the choice of CI, if CI is maintaining its Books of Accounts (BOA) on an accrual basis, then 85% of income was to be applied on the accrual basis and if BOA is maintained on a cash basis, then 85% of income was to be applied on actual payment basis.

Let's understand the above scenario with an example.

For example, Dayalu Trust is maintaining its BOA on the accrual basis and the following is the data for F.Y 2021-22

Particular	Amount
F.Y. 2021-22	
Income**(A)**	5,00,000
Exemption(15%) u/s 11**(B)**	75,000
Expenditure incurred (actually paid in F.Y 2021-22) **(C)**	3,25,000
Expenditure incurred (booked in F.Y 2021-22 but paid in F.Y 2022-23) **(D)**	1,00,000
Total Expenditure (C+D)	**4,25,000**

In the above example, AOI is 85% which meets the threshold for claiming tax exemption, and hence the Tax payable is Nil.

However, with the introduction of the Finance Act, 2022, an amendment has been brought which has completely changed the law of Taxation of CIs which was in existence since its inception. Now, only those expenses which have been actually paid during the relevant F.Y. will be considered for the calculation of AOI to the tune of 85%. [Explanation 3 to clause (23C) of section 10 and Explanation to section 11].

Now referring to the same example but considering only those expenses which are actually paid for the calculation of AOI:

Particular	Amount
F.Y. 2021-22	
Income(A)	5,00,000
Exemption(15%) u/s 11 (B)	75,000
Expenditure incurred (actually paid in F.Y 2021-22) (C)	3,25,000
Expenditure incurred (booked in F.Y 2021-22 but paid in F.Y 2022-23) (D)	1,00,000
Total Expenditure (C+D)	**4,25,000**

In the above example, the expenditure actually paid is Rs. 3,25,000. Hence, AOI is 65% which does not meet the threshold required to claim tax exemption. There is a shortfall in AOI which can be corrected through other mechanisms without paying any amount of Tax.

The following are the benefits cum reasons why the changes are being incorporated into the law**:**

1. To ensure true sense of charity i.e. actual AOI.
2. For reducing the complexity faced by income tax department during assessment
3. Equality between income and expense

1. **To ensure a true sense of charity i.e. actual AOI –** What does charity means in reality – **"the booking of the expenses only or actually paying amount towards the charitable purpose?"**
   Before this amendment, trusts had a practice of booking the expenses by increasing the payables in their BOA instead of actually paying those expenses. Also, these payables remained outstanding in the BOA of CIs for a long time.
   Now, only those expenses which have been actually paid during the relevant F.Y. will be considered for the calculation of AOI
2. **For reducing the complexity faced by the Income Tax Department during assessment –** As different CIs follow different methods of accounting i.e. mercantile basis or cash basis, it was creating a problem for the department to calculate AOI across different cases.
3. **Equality between income and expense –** Application shall now be considered only for the expenses actually paid but what about income which has not been received, how can CI spend the money when CI has even not received the same? For the income side, the CI always has the option to file Form 9A as per section 11(1) of the Income Tax Act,1961, for that part of income that has been accrued but not received by the institution or could not be spent due to some other reasons.

Also, according to Section 11(2) of the Income Tax Act, 1961, the CIs can file Form No. 10 and make an investment in modes specified u/s 11(5) to set aside income for greater CAPEX to be undertaken in the future, this option is generally taken if 85% of the application is not achieved by the institution. But for the expenses, there are no such provisions,i.e. to fill any form for that part of expenses that are not actually paid, therefore such an amendment has been made.

Now this amendment will create problems for those CIs who are maintaining their BOA on accrual basis because they were claiming income tax exemption benefits without actually paying 85% of income. However, those CI which are maintaining BOA on actual payment basis, are already in the practice of availing Income tax benefits only when they have actually applied 85% of their income. So, they are not affected by this amendment.

Every coin has two sides. In the same manner, this amendment also has some drawbacks. Let's put some light on these drawbacks:

• **Retrospective effect of such amendment –** Finance Act, 2022 was passed in the Lok Sabha on 25/03/2022. There is a misconception that since this amendment is brought through Finance Act, 2022, it should be applicable from A.Y. 2023-24. Instead of this, the amendment is applicable from A.Y 2022-23 i.e. it is applicable for F.Y 2021-22.

Because of this, the CIs have to face many difficulties as they have already prepared their BOA on accrual basis for 11 months and no such calculation has been done in advance as required by the new law.

Author's View: Many of the CIs have filed their return for the F.Y. 2021-22 on accrual basis which is totally against the law because they are not aware of the amendment and it creates a lot of litigation matters from the department side for many of the unknown issues. The CIs should be prepared for such litigations in advance.

• **Shifting from the mercantile basis of accounting to the cash method of accounting –** As per the amendment, the CIs are forcefully required to maintain their BOA on actual payment method in order to calculate AOI from BOA itself.

Author's View: The BOA can be maintained on accrual basis then calculation has to be prepared separately in addition to the BOA for calculation of AOI on actual payment basis, as per the amendment under discussion.

•Proper tracking of all expenses – The CIs are required to keep proper track of all the expenses whether revenue or capital, as regards the year in which these expenses or assets are booked in the BOA and in which years the payment for the same has been made.

•Ensuring Cash Flow Management –The CIs have to ensure proper management of cash inflows and outflows i.e. CFS. Although it is not mandatory in the case of CIs, however, as per the new law it seems that CIs must prepare CFS for strict compliance required by the new law.

Author's View: It is suggested to the CIs that from now onwards, they should discharge their liabilities in the same year in which it has been booked.

As the preparation of a cash flow statement is not compulsory under the law, it can be prepared in the following format instead of the actual format of CFS (used by Companies):

Particulars	Amount
Opening liability (can be claimed as AOI) as on 01.04.20XX	XXX
Add: Expenses booked in Income and Expenditure during the relevant F.Y.	XXX
Less: Closing liability (can be claimed as AOI) as on 31.03.20XX	XXX
Net amount paid during the year i.e. AOI	**XXXX**

<u>Complexity in the law – Section 11(6) of the Income Tax Act, 1961 v/s AOI on actual payment basis:</u>

Section 11(6) of the Income Tax Act, 1961 states that *where any income is required to be applied or accumulated or set apart for application, then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation or otherwise in respect of any asset, acquisition of which has been claimed as an AOI under this section in the same or any other previous year.*

This section states *that* depreciation on an asset will not be allowed in the calculation of AOI if the cost of acquisition of such assets has been claimed as an application of income.

Let's discuss an unforeseen issue created by the amendment introduced in the Finance Act, 2022 which has a serious impact on provisions of section 11(6). For this, the facts are as under:

Situation 1: Asset purchased through the trust's own funds (i.e. without availing any credit assistance from outside):

- The facts are as under:

Cost of Asset purchased	Rs. 1,00,000
Depreciation	10% under SLM

1. When the trust chooses for claiming Capital Expenditure for AOI:

Assuming the whole amount is paid in the year of purchase, the amount paid i.e. Rs**. 1,00,000 will be treated as AOI.**

2. When the trust chooses for claiming Depreciation as AOI:

Assuming the whole amount is paid in the year of purchase, Depreciation of Rs. 10,000 (Rs. 1,00,000*10%) will be treated as AOI each year for 10 years.

Situation 2: Asset purchased through Borrowed Funds (i.e. by availing credit assistance from either money lenders or Financial Institutions):

- The facts are as under:

Cost of Asset purchased	Rs. 1,00,000
Depreciation	10% under SLM
Rate of Interest	Nil
Amount paid in the year of purchase	Rs. 50,000
Amount of Borrowed funds	Rs. 50,000

1. When the trust chooses for claiming Capital Expenditure for AOI:

Amount paid i.e. Rs. 50,000 will be treated as AOI in the year of purchase and the balance of Rs. 50,000 will be claimed as AOI as and when the Loan is repaid.

2. **When the trust chooses for claiming Depreciation as AOI**:

In continuation of the above facts, let us consider some additional information as under:

Cost of Asset purchased	Rs. 1,00,000
Depreciation	10% under SLM
Rate of Interest	Nil
Amount paid in the year of purchase	Rs. 50,000
Amount of Borrowed funds	Rs. 50,000
Amount of Loan Installment paid	Rs. 5,000 each year (Repayment starts from the year of purchase itself)

Year	As per Books of Accounts		As per Income Tax Act	
	Carrying Amount of Asset purchased	Dep.	Cumulative amount paid	Dep.
1	1,00,000	10,000	55,000	5,500
2	90,000	10,000	60,000	6,500
3	80,000	10,000	65,000	7,500
4	70,000	10,000	70,000	8,500
5	60,000	10,000	75,000	9,500
6	50,000	10,000	80,000	10,500
7	40,000	10,000	85,000	11,500
8	30,000	10,000	90,000	12,500
9	20,000	10,000	95,000	13,500
10	10,000	10,000	1,00,000	14,500

From the above situation (when an asset is partially purchased from borrowed funds), it can be inferred that the recent developments in the law have compelled CIs to forcefully claim Capital Expenditure as AOI on actual payment basis rather than claiming depreciation as AOI since it shall complicate the process of record maintenance. Also, it can be seen from the table above, in any year, the amount of depreciation as per BOA and Income Tax is not equal. In initial years, the amount of depreciation claimed as AOI is lower than the depreciation booked in BOA but in later years, the amount of depreciation claimed as AOI is higher than the depreciation booked in BOA.

Hence, if a tie-breaker between BOA and Income Tax isn't achieved, that would result in a constant struggle of reconciliation. However, the total amount of depreciation claimed as AOI is Rs. 1,00,000 which is equal to the total amount of depreciation booked in BOA for 10 years.

For ease of understanding, in framing the second situation, the following assumptions have been taken:

1. Depreciation under the SLM method and not the WDV method has been considered.
2. The loan is considered to be interest-free.
3. No Moratorium period has been considered.
4. Only 1 asset has been purchased during the year

Author's view: In a nutshell, it is recommended that the CIs must think twice before adopting Depreciation as AOI when the Asset is acquired partially through borrowed funds, considering the work culture and style of operating of most of the CIs in India.

Questions untapped by the Lawmakers

- Income received in advance or any other amount received as a deposit – There is no provision for adjusting the Advance income received by the CIs, and no form is available for the same, like Income accumulation or deemed application of Income. The answer to the same is still untapped from the lawmakers' side.

- Expenses paid in advance or if any deposits are made by CIs –The same situation is in the case of expenses; i.e. what will be the treatment for advance given to the supplier or any deposits made during the year?

- An issue regarding amendment in Auditor's Report – As the law has changed tremendously since the last 5 years; some changes have been made in the return form too. However, the format of the Auditor's Report is different than the return form because no change has been incorporated in Auditor's Report since the last 10 years or more.

- A loan is taken to repay an existing loan: The amendments are being made to the return form, but there are no adjustments available in the return form for repayment of such loan.

Topic 3: Interpretation of General Public Utility – in line of Supreme Court Judgment

The recent SC judgement in the case of Assistant Commissioner of Income Tax v/s Ahmedabad Urban Development Authority ([2022] 143 taxmann.com 278) has finally settled the controversy which has been raging for years on laws regarding tax exemption under the GPU category and has given the autonomy, both to assessee and department, to critically examine each case in light of the said judgement.

Tax Exemption is available to institutions carrying out activities for 'Charitable Purpose' subject to fulfillment of prescribed conditions.

Section 2(15) of the Income Tax Act, 1961 defines "charitable purpose" to include:

(i) relief of the poor,
(ii) education,
(iii) yoga,

(iv) medical relief,
(v) Preservation of environment (including watersheds, forests and wildlife) and
(vi) Preservation of monuments or places or objects of artistic or historic interest, and
(vii) The advancement of any other object of general public utility.

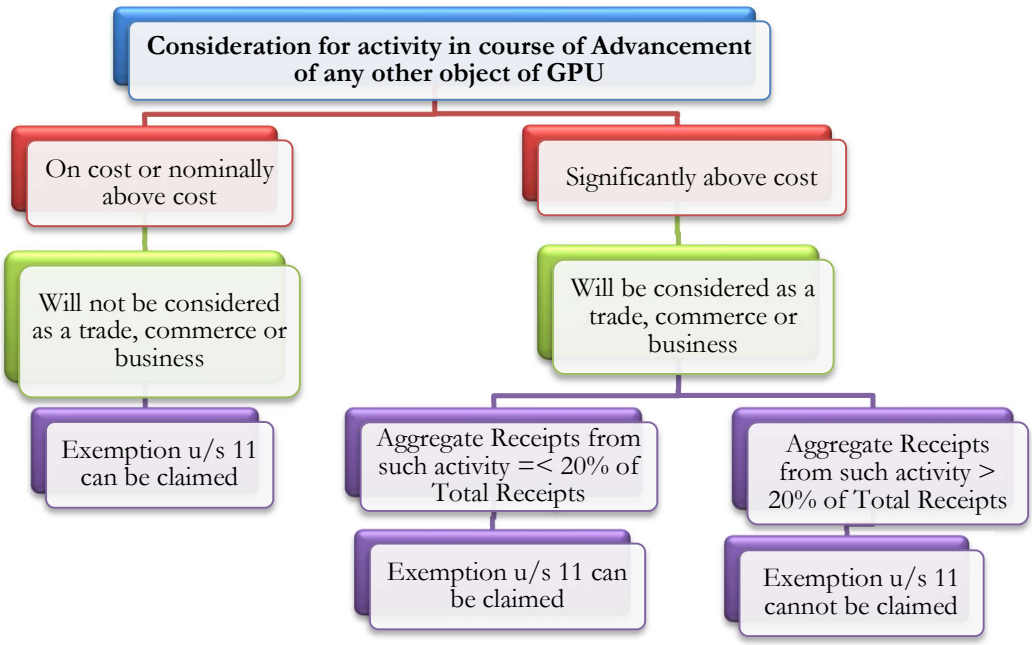
Provided that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of

- trade, or
- commerce or business, or
- any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity, unless—

i. such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and
ii. the aggregate receipts from such activity or activities during the previous year do not exceed 20% of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year.

Burning Issue:

As discussed above, Charitable Institutions under the GPU limb, cannot carry out business, trade or commerce unless it is carried out in the course of actually carrying out GPU, that to up to the prescribed limit of 20%, and also subject to nominal markup above cost and not significant profits. The said provision is applicable on Institutions engaged in advancement of GPU. However, Supreme Court's (SC) observations in a recent decision in case of Assistant Commissioner of Income Tax v/s Ahmedabad Urban Development Authority could be used to interpret other definitions of charity, thereby covering other limbs of charitable purpose like education, medical relief, yoga etc. in the mentioned provision. Meaning thereby, a school covered under education limb, with fee structure having significant profits can be viewed as non-charitable and might be stripped off its exemptions. The anticipation is still a far-fetched one and awaits department's interpretation in the coming years.



- **Conclusion**

  - This judgement will have far reaching implications for the entire world of Charity. The present SC ruling, being law of the land, will be highly useful to both taxpayers as well as tax authorities in interpreting the statutory provisions and approaching the claim of charity exemption.

  - Institutions will be required to modify their memorandum or constitution of incorporation to align them to include only those activities that are actually related to carrying out the objects of the GPU charity.

  - It seems that the decision would give autonomy to the Revenue to question activities of charities from the lens as to whether the same have been carried out with motive of profit judged from whether the services have been provided at cost / nominal mark up over cost or not and to initiate detailed scrutiny on the activities carried by such charitable trusts.

  - This would therefore become extremely subjective aspects, potentially inviting a fresh round of litigation. Also, there is ambiguity surrounding the "interpretation of cost". The determination of what constitutes a 'nominal markup' at the sole discretion of the Revenue (without any legislative approvals) seems like a hanging sword on the taxpayers.

  - The aforesaid decisions have far-reaching complications which may lead to denial of exemption provisions where activities are perceived to be carried on with a profit motive beyond what is permissible under the law, possible withdrawal of registration granted under the Act and penal consequences.

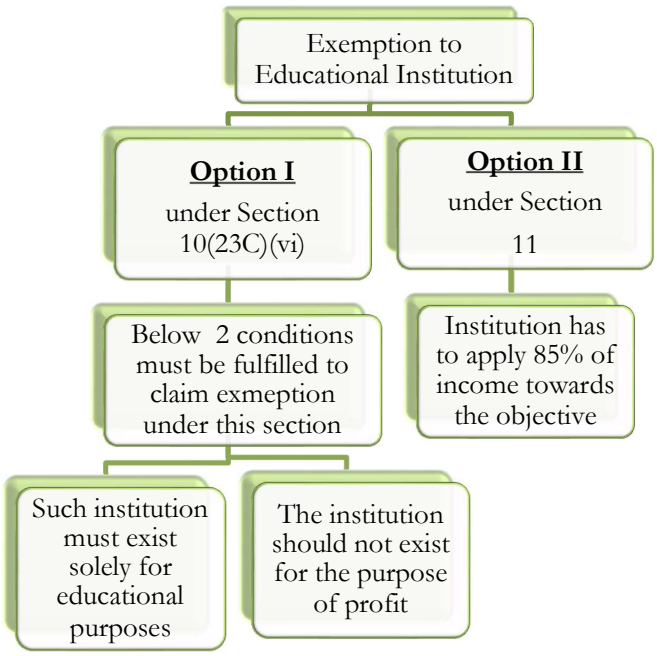
  - One may also have to be mindful of the provisions of section 115TD of the Act, which levies tax on the accreted income (excess of market value of assets over liabilities) of the charitable trusts where registrations are cancelled.

Topic 4: - Section 10(23C) - Meaning of Solely - in line of Supreme Court Judgment

The Supreme Court of India in a landmark judgment in case of New Noble Educational Society v/s The Chief Commissioner of Income Tax 1 and ANR ([2022] 143 taxmann.com 276) has overruled its own previous judgments (American Hotel and Lodging Association v/s CBDT [2008] 10 SCC 509B and Queens Education Society v/s CIT [2015] 8 SCC 47) and addressed many interpretational issues relevant to Educational Institutions claiming exemption u/s 10(23C)(vi) of Income Tax Act, 1961 .

This includes correct meaning of word "solely", clarification on profit motive, compliance with other/local laws and scope and extent of inquiry by Prescribed Authority.

In addition, the Supreme Court (SC) has also explained the meaning and scope of term 'education', permissible activities for Educational Institutions, incidental activity etc.



1. Meaning of Education

Education in its natural sense means any activity which is sought to increase any knowledge. But while granting approval to institution, meaning of education becomes narrower and is limited to only formal schooling.

Education means mainstream curriculum – based education and not education as is broadly or commonly understood.

2. 'Solely' means 'only'

Institution should be "solely" for the purpose of education. The plain and grammatical meaning of the term 'sole' or 'solely' is 'only' or 'exclusively'.

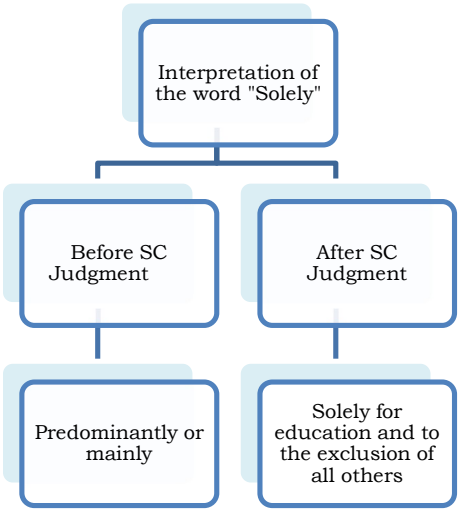
Earlier, Supreme Court in the context of education in following two cases interpreted solely as 'predominantly':

•American Hotel and Lodging Association v CBDT (2008) 10 SCC 509 B)

•Queens Education Society v Commissioner of Income Tax (2015) 8 SCC 47

In above judgments, while determining whether an institution is engaged 'solely' for education, the court has considered the objects in a wider sense by applying the predominant test, which means that education should be the predominant object and major activities are around to this object. However, the meaning and conclusion of both the judgments are overruled by this SC judgment. The SC has interpreted 'solely' as 'solely for education and to the exclusion of all others.'

The same can be understood through the following chart:



3. Object must be educational

The SC has held that the application of 'predominant object' test was clearly inapt in the context of charities set up for advancing education.

In simple words, all objects of trust, society etc. claiming exemption u/s 10(23C)(vi), must relate to either imparting education or be related with educational activities.

4. What about incidental activity??

Institutions undertaking activities 'incidental' to education would be eligible for exemption, that is, institutions may take up other activities in furtherance of education for the benefit of students.

The SC in its judgment described the word 'incidental' as follows:

The word 'incidental' means according to Webster's New World Dictionary:

"Happening or likely to happen as a result of or in connection with something more important; being an incident; casual; hence, secondary or minor, but usually associated:"

"Something incidental to a dispute" must therefore mean something happening as a result of or; in connection with the dispute or associated with the dispute. The dispute is the fundamental thing while something incidental thereto is an adjunct to it.

Something incidental, therefore, cannot cut at the root of the main thing to which it is an adjunct."

'Incidental' therefore, means, in the context of the present case, something connected with the activity of education. Such incidental activities alone, in the absence of the actual activity of imparting education by normal schooling and normal conduct of classes, would not suffice for the purpose of qualifying the institution for the benefit of section 10(23C)(vi).

5. Incidental Activity has to be for its students only

The SC judgement also clarified the ambiguity that while imparting education, institution can provide other activities, which are incidental to imparting education like:

- Workshops
- Seminars
- Educational Courses (Relating to computer etc.)
- Hostel
- Summer Camp
- Transportation
- Catering

6. No profit motive in any activities

The interpretation of Section 10(23C) is that the trust or institution must solely exist for the object it professes (in this case, education, or educational activity only), and not for profit.

However, the seventh proviso of Section 10(23C)(vi) carves an exception to this rule, and permits the trust or institution to record (or earn) profits, provided the 'business' which has to be read as education or educational activity that is incidental to the attainment of its objectives.

In simple words, if surplus accrues in any year or set of years per se (when profit is not a motive), it is not a bar, provided such surplus is generated through or incidentally through the course of educational activity.

If, incidentally, while carrying on those objectives, the trust earns surplus, it has to maintain separate books of accounts.

7. Applicability of Other Laws

The SC states that the requirement of registration of every charitable institution is mandatory under respective state/local laws while seeking approval. Wherever registration of institution (trust, society, section 8 company, non –trading company etc.) is obligatory under state or local laws, the concerned institution seeking approval u/s 10(23C) should also comply with provisions of such state laws.

As per author's understanding, only 5 states (Rajasthan, Andhra Pradesh, Madhya Pradesh, Gujarat and Maharashtra) have respective state laws for registration of Charitable Institutions in India.

8. Conclusion

- This SC Judgment has made institutions to have a total introspection on its purview of activities.
- The Institutions approved u/s 10(23C)(vi) are required to check its objects and if required, amend its objects to ensure only educational activities &activities incidental to education.
- Institutions have to identify income from activities solely for purpose of education and in relation of other activities incidental with educational activities.
- Extent of verification by the AA, for providing approval of 10(23C), now, cannot be restricted to objects only and has significantly increased to multiple folds. They can ask for audited accounts and other documents, as required.
- Institutions are now mandatorily required to comply with the provisions of state law also.
- In order to maintain the lucidity of the article, author has only explained the scenario from the perspective of education as covered u/s 10(23C)(vi), however, the complete article shall verbatim hold true for medical institutions approved u/s 10(23C).

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