J. B. NAGAR
CPE STUDY CIRCLE

SUBJECT

TAXATION OF CHARITABLE TRUST – LATEST AMENDMENTS AND JUDGMENTS

ON 28TH MAY, 2023

-CA. VIPIN BATAVIA-

FINANCE ACT, 2022

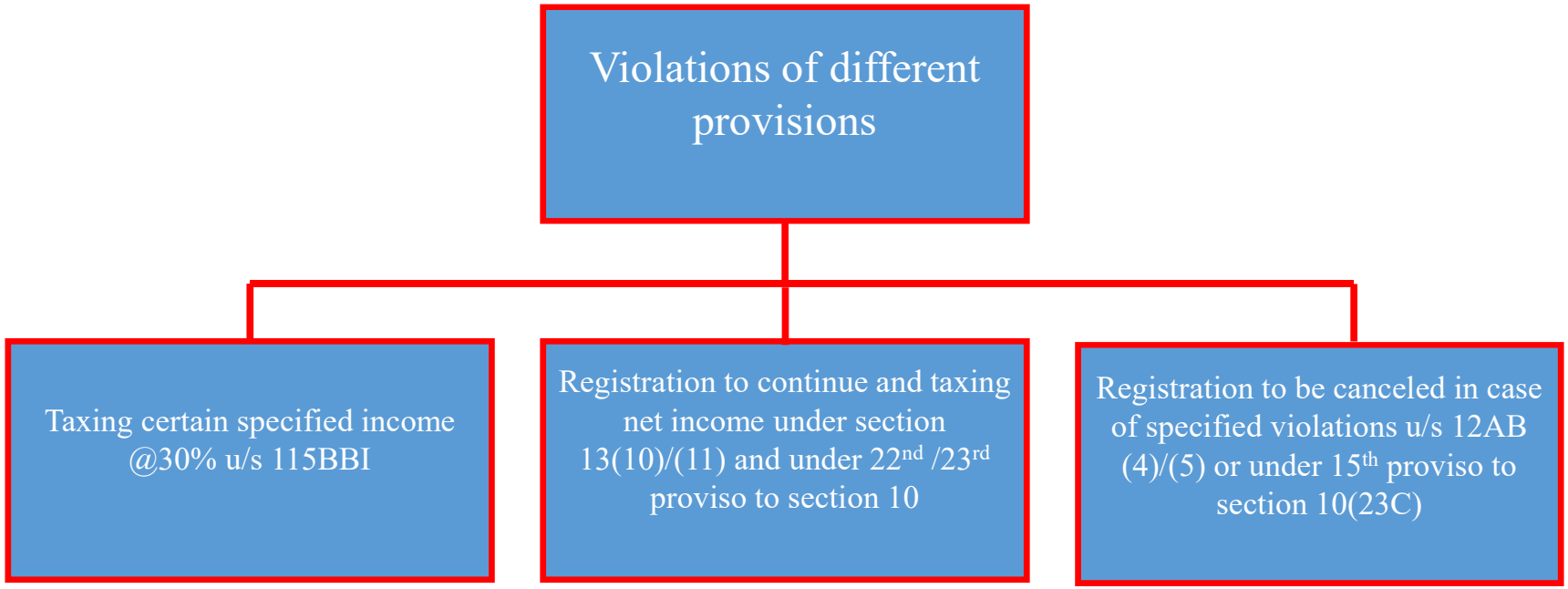
Changes in the Finance Act, 2022

1) Alignment of two regimes

2) Providing clarity in taxation in case of violation

3) Effective monitoring

Changes in the Finance Act 2022- Providing clarity in taxation



A) Exemption to trust or institution is available under the Income Tax Act under two regimes:

1) Regime for the trust or institutions obtained approval u/s.10 (23C)(iv), (v), (vi) or (via) of the Act; and

2) Regime for the trusts registered u/s.12AA/12AB of the Act.

B) Amendment in provisions related to accumulation of income by 10(23C) trusts Brought in par with Sec. 11(2)

* **Existing provision**

→ Accumulation u/s. 11(2) – for specific purpose for 5 years
→ Form 10 is to be filed before the due date of filing of ITR
→ The money is to be invested prescribed modes specified u/s. 11(5)

* **Amended Provision u/s. 10(23C)**

→ Before the amendment, third proviso to section 10(23C) had similar provisions, but there was no provision to file Form 10 now form 10 is required to be filed for the accumulation more than 15% of income is accumulated.
→ The said accumulation is to be utilized wholly and exclusively to the objects for which it is established.
→ And to invest money in forms or modes specified u/s.11(5) of the Act.
→ Hence to bring consistency between provisions under two regimes, explanation 3 to third proviso to section 10(23C) is inserted to provide for all conditions mentioned above for accumulation of income u/s. 11(2).
→ Also, explanation 5 inserted to third proviso to allow trust or institution to utilize the accumulated income for such other purpose in India in circumstances beyond control subject to fulfillment of specified conditions. These provisions are similar to provisions of section 11(3A) of the Act.

Utilization of accumulated fund to be spent in 5 years (Not in the 6th year) (w.e.f. AY 2023-24)

* **Existing provision**

→ As per the Section 11(3) and as per explanation 4 inserted to third proviso to section 10(23C) the accumulated income is not applied within 5 years, the same shall be taxed in the 6th year.

* **Amended provision**

→ As per the Section 11(3) and as per explanation 4 inserted to third proviso to section 10(23C) the accumulated income is not applied within 5 years, the same shall be taxed in the 5th year itself which is to be taxed in the 5th year.

C) Application of Income to be allowed on payment basis (w.e.f. AY 2022-23)

(Explanation inserted after Sec. 11(7))

Irrespective of method of accounting followed

Earlier liabilities paid during the year will not be allowed as application of income

D) Cancellation of registration/approval in certain circumstances

* Existing provision

→ The CIT had power w.e.f. 01.10.2004 to cancel registration in the circumstances –
i) where the activity of the trust are not genuine or
ii) the activities or not carried out in accordance with objects of the trust.

→ The finance Act, 2014 provided additional condition for cancellation for a violation u/s 13(1) -
i) Income does not provide benefit to the general public.
ii) Benefit for any particular religious community or caste.
iii) Any income of the property applied for the benefit of specified persons like author, trustees etc.
iv) Funds are invested in prohibited modes than prescribed u/s. 11(5).

→ Further Additional powers given to CIT for cancellation w.e.f. 01.09.2019 that if the trust has not complied with the requirement of any other law **which are material for the purpose of achieving its objects** and such non-compliance order, direction or decree is either not disputed or attaint finality.

* **Amended provision**

→ As per new Sec. 12AB w.e.f. 01.04.2021 has provided additional power for cancellation at the time of renewal after the end of 5 years.

→ Amended provisions of section 12AB (4) and (5) and fifteenth proviso to section 10(23C) w. e. f. 1st April, 2022.

→ As per the amendment Section 12AB(4) and Section 10(23C) and where the registration or provisional registration has been granted to the trust or institution and subsequently it is noticed by PCIT/CIT –

i) Occurrence of one or more specified violations during any previous year or

ii) Has received a reference from the Assessing Officer under the second proviso to section 143(3) for any previous year; or

iii) such case has been selected in accordance with the risk management strategy formulated by the Board from time to time for any previous year,

Specified Violations

→ The trust or institution has been applied other than for the objects for which it is established; or

→ The trust or institution has income from profits and gains of business which is not incidental to the attainment of its objectives or separate books of account are not maintained by it in respect of the business which is incidental to the attainment of its objectives; or

→ The trust or the institution has applied any part of its income from the property held under a trust for private religious purposes which does not ensure for the benefit of the public; or

→ The trust or institution has applied any part of its income for the benefit of any particular religious community or caste (As per explanation 2 trust created for the benefit of SC, BC, ST or women and children will not be covered);

→ Any activity being carried out by the trust or the institution
(i) **is not genuine; or**
(ii) is not being carried out in accordance with all or any of the conditions subject to which it was registered; or

→ The trust or the institution has **not complied with the requirements of any other law**, **which are material for the purpose of achieving its objects** and the order, direction or decree, by whatever name called, holding **that such non-compliance has occurred, has either not been disputed or has attained finality.**

* **Time limit for passing cancellation order**

→ Moreover, it is provided to pass such order cancelling the registration before expiry of period of six months from the end of the quarter in which the first notice is issued by the Principal Commissioner or Commissioner on or after 1st April, 2022 calling for any document or information or for making any inquiry.

* **AO shall send reference for cancellation**

→ Moreover, as per the amendment in.143(3), where the Assessing Officer is satisfied that any trust or institution under both regime has committed any specific violations mentioned above, he shall-

→ Send a reference to the Principal Commissioner or Commissioner to withdraw the approval or registration, as the case may be; and

→ **No order making an assessment of the total income or loss of such fund or institution or trust shall be made by him without giving effect to the order passed by the Principal Commissioner or Commissioner under clause (ii) or (iii) of the fifteenth proviso to section 10(23C) or clause (ii) or (iii) of section 12AB (4).**

E) Computation of income in case of denial of exemption (New Sec. 13(10) inserted w.e.f. 01-04-2023)

→ **Under both the regime –**

i) Violation of proviso to Sec. 2(15) (Exclusion – such activity is undertaken in the course of actual carrying out and having aggregate receipts less than 20%)

ii) In case of not getting the books of accounts audited

iii) Not filed return of income u/s. 139(4A) within time allowed u/s. 139(1) or 139(4) (Belated)

→ There was lack of clarity on computation of income in such circumstances. Hence, section 13(10) inserted to provide that in case of non-availability of exemption in circumstances mentioned above, its income chargeable to tax shall be computed after allowing deduction for the expenditure **(other than capital expenditure)** incurred in India for the objects of the trust or institution.

Subject to fulfillment of following conditions.

→ Such expenditure is not **from the corpus**;
→ such expenditure is **not from any loan or borrowing**;
→ **Claim of depreciation which** is not allowable as per Sec. 11(6)
→ such expenditure is not in the **form of any contribution or donation to any person.**

→ The provisions of **section 40A(ia) and section 40A(3) and (3A)** are also applicable.

→ **No expenditure or allowance or set-off of any loss** shall be allowed to such trust or institution

→ **Also, no deduction in respect of any expenditure or allowance or set-off of any loss shall be allowed under any other provisions of this Act.**

F) <u>Only amount applied in violation shall be liable to be included in total income</u>

→ **Moreover, in the case of violation of provisions of section 13(1)(c), 13(1)(d) and 13(3), exemption u/s.11 can be denied.**

→ The trust and institution under both the regime amended section 13(1)(c) and 13(1)(d) and to insert twenty-first proviso to section 10(23C) **to provide that in case of violation of said section, only that part of income which has been applied in violation to the provisions of said clause shall be liable to be included in total income.**

G) New Section 115BBI is inserted to define specified income of certain institution (w.e.f. AY 2023-24)

1) Specified income of the trust or institution is taxable at special rate.

This section provides that any income by way of any specified income will be taxed as under on aggregate of-

(i) the amount of income-tax calculated at the rate of thirty per cent on the aggregate of specified income; and

(ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the aggregate of specified income referred to in clause (i).

2) No deduction in respect of any expenditure or allowance or set off of any loss shall be allowed to the assessee under any provision of the Act in computing specified income.

<u>Explanation for Specified Income –</u>

→ Income accumulated or set apart in excess of fifteen percent of the income where such accumulation is not allowed under any specific provisions of the Act; or

→ Deemed income referred in Explanation 4 to third proviso to section 10(23C) (Violation similar conditions like 11(2) or section 11(3) (Violation of condition of 11(2)) or of section 11(1B) (As per 9A) or

→ Any income which is not exempt under section 10(23C) on account of violation of the provisions of clause (b) of third proviso of section 10(23C) or not to be excluded from total income under the provisions of section 13(1)(d) (Investment of funds in impermissible modes) or

→ Any income which is deemed to be income under the twenty first proviso to section 10(23C) or which is not excluded from total income under section 13(1)(c) (Benefit to interested person) or

→ Any income which is not excluded from total income under section 11(1)(c). (Income applied outside in India not permitted)

H) Penalty for passing on unreasonable benefit to trustee or specified persons

→ As specified u/s.13 trusts or institutions under second regime are required not to pass on any unreasonable benefit to the trustee or any other specified person.

→ There was no such provision for the trust or institutions under first regime.

→ Hence to bring consistency in the provisions of two regime, it is amend to **insert twenty-first proviso to section 10(23C) w.e.f. A.Y. 2023-24**

→ **Provide that where such trust or institution has applied directly or indirectly income or any part of income for the benefit of any person referred to in section 13(3) of the Act, such income or part of income or property shall be deemed to be the income of such person of the previous year in which it is so applied.**

→ Moreover, provisions of section 13(2), (4) and (6) (Benefit to interested person) are also applicable to trust or institution under first regime.

I) <u>Penalty for violation for benefit to specified persons (Sec. 271AAE) (w.e.f. AY 2023-24)</u>

*** <u>Existing provision</u>**

→ There was provisions to tax the amount applied in violation of these provisions as deemed income and there was no provision of penalty for misuse of funds of the trust or institutions.

*** <u>Amended provision</u>**

<u>SECTION -271AAE - Penalty for violation of Sec-13 (C) and 21st Proviso to sec -10(23C)</u>

As per the section 271AAE, if during any proceedings, it is found that any trust or institution under first or second regime has **violated provisions of twenty-first proviso of section 10(23C) or section 13(1)(c) ,** the Assessing Officer may direct such person to pay by way of penalty –

i) **Violation for first time during any previous year** - Equal to the aggregate amount of income so applied (100%).

ii) **Violation for subsequent year** - Twice the amount of aggregate amount where the violation is noticed again in any subsequent previous year (200%).

iii) This penalty is leviable in addition to the penalty leviable, if any under any of the provisions of Chapter – XXI .

J) Treatment of donation received for renovation and repair of temple (w.e.f. AY 2021-22)

Notified Temple, Mosque, Gurudwara, Church or other place
Donations received for renovation or repair at its option to be treated as corpus donations

Public Charitable trusts or institutions under both the regime are receiving donation for repairs or renovation of temple, mosque, gurdwara, church held as trust property or for the other places notified u/s.80G(2)(b) of the Act.
There was no clear provision regarding treatment of such donation as corpus donation. Insert explanation 3A in section 11(1) and explanation 1A in section 10(23C) w. e. f . A.Y. 2021-22 so as to provide that such **trust may at its option treat such donation as forming part of the corpus donation**

Subject to the condition that the trust or institution-

a) applies such corpus only for the purpose for which the voluntary contribution was made;
b) does not apply such corpus for making contribution or donation to any person; and
c) maintains such corpus as separately identifiable;
d) invests or deposits such corpus in the forms and modes specified under subsection (5) of section 11.

Violation of condition
However, if the trust or institution has treated such donation as forming part of corpus donation and subsequently any of the conditions mentioned above are violated, such sum shall be deemed to be the income of such trust or institution of the previous year during which the violation takes place. This is by inserting explanation 3B in section 11(1) and explanation 1B in section 10(23C) of the Act.

Maintenance of Books of Accounts and Other Documents

The Finance Act, 2022 Substituted in Sec. 12A(1)(b) and tenth proviso to Sec. 10(23C) w.e.f. 01.04.2023, accordingly it will be applicable from AY 2023-24 (FY 2022-23).

As per substituted section 12A (1) (b) and tenth proviso to section 10(23C) that where the total income of the trust or institution under both the regimes, without giving effect to section 11 or section 10(23C) exceeds the maximum amount which is not chargeable to tax, such trust or institution shall keep and maintain books of account and other documents in such a form and manner and at such place, as may be prescribed. These amendments will take effect from 01-04-2023 and accordingly will apply for A.Y. 2023-24 and subsequent assessment years.

In pursuance to the aforesaid amendment the CBDT issued a notification on 10th August, 2022 vide G.S.R. no 622(E) and made amendments to rules by Income tax (24th Amendment) rules, 2022. These rules came in to force from the date of the notification i.e., w.e.f. 10-08-2022.
The new rule 17AA is inserted after rule 17A.

Notes-

i) *It is to be noted that there is an income limit is prescribed for the keeping and maintaining the books of accounts and other documents. The said income limit presently is 2.50 lakhs.*

ii) *There is an ambiguity about the applicability of the date of the provision, vis-à-vis to Assessment Year, since the section says it is to be maintained for the F Y 2022-23 onwards however the notification is issued and is came into force with effect from 10-08-2022.*

Hence it is advisable to follow the act and to make attempt to maintain books of accounts and documents for the F Y 2022-23 to the best extant it is possible.

As per new rule 17AA – Every fund or trust or institution etc. which is required to keep and maintain books of account and other documents under clause (a) of tenth proviso to section 10(23)(C) or under sub clause (i) of section 12A(1)(b) shall keep and maintain books of account and other documents as mentioned herein below.

1) Cash book, ledger, journal, original and copies of bills, any other book that may be required to be maintained in order to give a true and fair view of the state of affairs.

2) Books of Accounts as referred above for business undertaking (Sec. 11(4) and business carried on by the trust (Sec. 11(4A)

3) Other Documents for maintaining

i) Record of all projects undertaken

ii) Record of all income: Voluntary contribution, income from property, other income

iii) Details of application of income, donation to other charitable entities, application outside India, details of income deemed as income of next year on receipt, accumulation of income, money invested in 11(5), not invested in 11(5)

iv) Details of application out of accumulation income, accumulation invested in 11(5), not invested in 11(5)

v) Details of corpus donation: application out of it, amount credited back out of current year income, donation to other charitable entities, invested in 11(5) or not invested in 11(5)

vi) Details of amount received for repair/renovation of 80G(2)(b) religious place treated as corpus donation: application out of it, amount credited back out of current year income, donation to other charitable entities, invested in 11(5) or not invested in 11(5)

vii) Details of loan and borrowings: Details of loans and borrowings name and address of the lender, PAN and Aadhar (If available) of the lender, receipt, terms and conditions of repayment, application out of loans of current year and earlier years, details of repayment.

viii) Details of properties held –

a) Immovable Property – Nature and address of properties, **Cost of Acquisition of Assets, r**egistration Documents.

B) Movable Properties including details of nature and cost of acquisition.

ix) Record of specified persons (As referred to Sec. 13(3)) and details and nature of transaction and **documents to the effect that such transaction is directly or indirectly not for benefit for them**.

x) Any other documents containing other relevant documents.

4) The books of accounts and other documents may be kept in written form or in electronic form or in digital form or as printouts of data or any other form of electromagnetic data storage device.

5) The books of accounts and other documents shall be kept and maintained at its registered office.

Provided the books of accounts and other documents may be kept at such other place in India as the management decide by way of resolution and **the said resolution to be intimated to AO in writing within 7 days thereof with giving full address of that other place**. The said intimation is to be given by the person who is authorized to verify return of income.

6) The books of accounts and other documents shall be kept and maintained for a period of **10 years** from the end of the relevant assessment year.

In case where the assessment reopened under section 147, the books of accounts and documents which were kept and maintained at the time of reopening shall continue to be so kept and maintained till the re-assessment has become final.

L) Other Amendments

→ Provisions of section 115TD, 115TE and 115TF are to be amended w. e. f .A.Y. 2023-24 to make them applicable to first regime as well.

→ Also, first and second proviso to section 10(23C) provided to file application for approval before prescribed authority. It is to amend these provisos w. e. f. 1st April, 2022 to provide that application for approval under first regime shall be filed before the Principal Commissioner or Commissioner.

→ Moreover, to remove drafting error in section 35(1A), it is to amend said section w. e. f. 1st April, 2021, to provide that only the deduction claimed by the institutions referred to in section 35(1)(ii), (iii) or (iia) shall be disallowed unless such institution filed statement of donation in Form 10BD, and not the deduction claimed by such institution.

Finance Bill – 2023 Proposals with Respect to Charitable and Religious Trust

A) INTER-CHARITY DONATIONS –

Background–

→ Inter-charity donation is permissible but it is to be ensured that inter charity donation is given for the similar objects for which the donor trust is created.

→ Inter charity donation (other than towards corpus) is treated at par with direct application for the purpose of sections 11(1) (a) and 10(23C). It is also held that inter charity donation is treated at par with direct utilization of funds.

→ Corpus donation given by a section 12AA/12AB registered trust/institution to a 12AA/12AB registered NGO as well as to section 10(23C) approved institution is not treated as an application of income.

→ Funds accumulated under Sec. 11(2) are not allowed to be donated to other trust /institution. It is to be directly applied for the specific purpose for which it is accumulated. However, inter-charity donation out of accumulated funds under Sec. 11(2) may be permissible in case of dissolution of a trust.

→ Inter-charity donation to a non-section 12AA or a non-FCRA organization is generally not permissible but has not been held as illegal activity or a reason for cancellation.

→ A charitable organization can be considered as charitable in nature even if the entire donation mobilized is given as inter-charity donation.

→ The funds given as inter-charity donation shall be treated as application of income even if it might not have been applied by the donee trust. However, the donee trust has to apply them for charitable purposes only. (CBDT instruction No. 1582, dated 19-10-1984)

The Finance Act , 2023 has an amendment to inter trust donations that only 85% of eligible donations made by a trust or institutions out of the income of the fund or trust or institution etc… under both the regime to another trust shall be treated as application only to the extent of 85% of such donation. Accordingly there are amendments carried out in first and second regime.

(The effective date is w.e.f. 1.4.2024 i.e. from AY 2024-25 and subsequent years.)

Examples for inter-charity donation and its impact (My personal view) –

Sr. No.	Particular	Income	Donated to another Trust	Amount spent	Total Application of Income	15% Accumulation	Accumulation (Form 9A or 10)	Balance Income (Tax Rate ?)
1	As per Old Provision	1.00 Cr.	50 Lakh	50 Lakh	1.00 Cr.	NIL	NIL	NIL
2	New Provision	1.00 Cr.	1.00 Cr. (@85%)	NIL	85 Lakh	NIL	NIL	15 Lakh
3	New Provision	1.00 Cr.	50 Lakh @85%= (42.5 Lakh)	50 Lakh	92.50 Lakh	NIL	NIL	7.50 Lakh
4	New Provision	1.00 Cr.	50 Lakh @85%= (42.5 Lakh)	25 Lakh	67.50 Lakh	15 Lakh	17.50 Lakh	NIL

Note – If the balance income falls under specified income then the tax rate will be 30% otherwise it will be at normal rate.

B) APPLICATION OF INCOME –

i) As per Finance Act, 2021 w.e.f. 01.04.2022 amended Sec. 11(1)(d). As per amendment the deduction u/s. 11(1)(d) for corpus donations will be allowed subject to the condition that such voluntary contribution are invested or deposited in permitted modes specified in Sec. 11(5), maintained specifically for such corpus.

ii) As per amended explanation 2 to Sec. 11(1) w.e.f. 01.04.2021 – Any amount credited or paid out of income to any fund, trust or institution etc. being as a corpus donation shall not be treated as application of income.

iii) As per Finance Act, 2021 w.e.f. 01.04.2022 explanation 4 is inserted -

For the purposes of determining the amount of application-

i) **Corpus Deposited Back -** Corpus donations received during the year shall not be treated as an application of income in the same year however it will be allowed as an application of income in the year in which it is invested and deposited back in modes specified u/s. 11(5) out of income of that year.

ii) Similarly any loan and borrowings shall not be treated as an application of income however it will be allowed as an application of income in which the loan and borrowings or part thereof is repaid out of the income of that year and to the extent of such re-payment.

The Finance Act, 2023 has following amendments under both the regime –

1) The amount invested or deposited back shall not be treated as application for charitable or religious purposes unless such investment or deposit is **made within a period of five years** from the end of the previous year in which such application was made from corpus.

2) The amount of loan & borrowings (L&B) repaid shall not be treated as application for charitable or religious purpose unless such repayment is **made within a period of five years** from the end of the previous year during which such application was made out of loan or borrowing;

3) The utilization of corpus, loans or borrowings by a charitable or religious trust **on or before 31.03.2021** will not be considered an application for charitable or religious purposes if the amount is subsequently deposited back into the corpus or the loan is repaid.

4) **Further provisions of deposited back shall apply only if there was no violation of the condition specified as under** – (inserted ibid From 01.04.2022) (Applicable for both the regime)

i) Such application should not be in the form of corpus donation to another trust.

ii) TDS, if applicable, should be deducted on such application.

iii) Cash Payments of payments made to a person in a day more than Rs. 10,000/- is not allowed (Sec. 40(A3).

iv) Carry forward and set off of excess application is not allowed.

v) Application is allowed in the year in which it is actually paid.

vi) Application should not directly or indirectly benefit any person referred to in section 13(3)of the Act.

vii) Application should be in India except with the approval of the Board in accordance with the provisions of clause (c) of sub-section (1) of section 11 of the Act.

C) <u>AMENDMENT IN DUE DATE FOR SUBMISSION OF FORM 9A & 10 (ACCUMULATION)</u>
<u>(w.e.f. 01-04-2023 and will accordingly apply to AY 2023-24 and subsequent years)</u>

In order to claim the accumulation of income, trusts or institutions under both the regime must file form 9A and Form 10 for accumulation of income **at least two months prior** to the due date for filing the return of income (i.e. by 31st August)

<u>CBDT CIRCULAR No. 06 of 2023 DATED 24.05.2023</u> –

As per point no. 15 of the said circular the accumulation / deemed application shall not be denied to a trust as long as statement of accumulation / deemed application is furnished on or before the due date of furnishing the return as provided in sub-section (1) of section 139 of the Act.

D) FILING OF ITR WITHIN DUE DATE FOR CLAIMING EXEMPTION

(w.e.f. 01-04-2023 and will accordingly apply to AY 2023-24 and subsequent years)

The exemption can be claimed by trust or institution only if return of income is furnished within time limit prescribed under Sec. 139(1) or 139(4).

Now with this amendment the exemptions can be claimed by trusts or institutions only if return of income is furnished within time limit prescribed under Sec. 139(1) or 139(4). As per this amendment now a charitable trust / institutions can file ITR u/s. 139(4) up to the time prescribed for the belated returns. This provision is applicable for AY 2023-24.

E) <u>UPDATED RETURN (w.e.f. 01-04-2023 and will accordingly apply to AY 2023-24 and subsequent years)</u>

It is to amend that in case of filing updated return the exemption will be available only if ITR has been furnished within time allowed u/s. 139(1) or 139 (4).

Section 139 of the Act was amended by the Finance Act, 2022 providing for an option to the taxpayers to furnish updated return of income at any time within 24 months from the end of relevant assessment year.

As per Memorandum explaining the provision this resulted in unintended consequences of allowing exemption under section 11, 12of the Act and sub-clause (iv)/ (v)/ (vi)/ (via) of clause (23C) of section 10 of the Act will be available to the trusts where they furnish updated return of income. Accordingly, it is to clarify that the exemption under section 11, 12 and sub-clause(iv)/(v)/(vi)/(via) of clause (23C) of section 10 of the Act will be available only if there return of income has been furnished within the time allowed under sub-section (1) or subsection(4) of section 139 of the Act.

F) <u>OMISSION OF PROVISOS SECOND, THIRD AND FOURTH TO SECTION 12A (2) (w.e.f. 01 April, 2023)</u>

As per Sec. 12A(2) the exemption u/s. 11&12 were available in relation to income from the Assessment year immediately following the financial year in which such application is made. However there are Four provisos to Sec. 12A (2).

The **first proviso** says that the provisions of Sec. 11&12 shall apply to a trust or institution where application is made under –

(a) re-registration under section 12(A) 1 (ac) (i) from the assessment year from which such trust or institution was earlier granted registration and

(b) for the new trust obtained provisional registration under Sec. 12(A) 1 (ac) (iii) from the first of the assessment year for which it was provisionally registered.

The **Second proviso** says where the registration has been granted u/s. 12AA or 12AB then provisions of Sec. 11&12 shall apply in respect of any income derived from the property held under the trust of any assessment year preceding the aforesaid assessment year for which assessment proceeding is pending before AO as on the date of such registration and objects and the activities remained the same for such preceding assessment year.

The **Third proviso** says the AO shall not take any action u/s. 147 in case of such trust for any assessment year preceding the aforesaid assessment year only for non-registration of such trust / institution. **The Fourth proviso** says that the provisions of First & Second proviso shall not apply in case the trust or institution which was refuse registration or registration granted was cancelled any time u/s. 12AA or 12AB.

It is to omit Second, Third & Fourth proviso to Sec. 12A (2).

G) SPECIFIED VIOLATIONS (w.e.f. 01 April, 2023)

Insertion of one more specified violation is added as under –
(for applications made for 10(23C) (iv)(v)(vi)(via) which is approved or provisionally approved and for all situations mentioned in Sec. 12A(1)(ac)

a) It is to insert clause (e) in explanation 2 to the fifteen proviso of Sec. 10(23C) of the Act to provide that the specified violation shall also include the case where the application referred to in first **proviso is not complete or it contains false or incorrect information for the first regime.**

b) It is to insert clause (g) in explanation to sub-section (4) of section 12AB of the Act to provide that the specified violation shall also include the case where the application referred to Sec. 12A (1) (ac) of the Act is **not complete or it contains false or incorrect information for the second regime.**

H) <u>TRUST / INSTITUTION CAN APPLY DIRECTLY FOR FINAL REGISTRATION / APPROVAL (w.e.f. 01 October, 2023)</u>

The trust or institution under the first and second regime were allowed to make application for provisional registration& approval u/s. 80G even before the commencement of activities. Now it is that where the trust has already commenced activities they can directly apply for regular registration and approval u/s. 80G under both the regime.
All other procedures prescribed for regular registration will have to be satisfied.

CBDT Circular 06 of 2023 dated 24.05.2023 has extended certain dates for filing of 10A for re-registration & approval and for form 10AB for regular registration. Explained in details at slide no. 46 & 47

I) <u>EXEMPTION TO DEVELOPMENT AUTHORITIES</u>
(w.e.f.01-04-2024 and will accordingly apply to AY 2024-25 and subsequent years)

Amendment in Sec. 10(46) & insertion of new Sec. 10(46A)is an outcome of Hon'ble Supreme Court decision in the case of Ahmedabad Urban Development Authority in civil appeal no. 21762 of 2017 vide order dated 19-10-2022.

Sec. 10(46) of the Act provides exemption to any specified income arising to a Body or Authority or Board or Trust or Commission or a Class thereof which –

a) has been established or constituted by or a under central, state or provincial Act or By Central or State Govt. with an object of regulating or administrating any activity for the benefit of general public,

b) is not engaged in any commercial activity and,

c) is notified by Central Govt. in official Gazette.

There was restriction on undertaking a commercial activities by a body or authority or board or trust or commission notified u/s. 10(46) has been a litigated issue.

Hon'ble Supreme Court in the case of Ahmedabad Urban Development Authority held that in Sec. 10(46)(b) the word "commercial" has the same meaning as trade, commerce or business in proviso to Sec. 2(15). Therefore, sums charged by these entities will require similar consideration i.e. whether it is at cost with a nominal markup or significantly higher, to determine whether it falls within the mischief of commercial activity or not.

However the Apex Court has observed that such entities are established for achieving essential public functions / services. In such cases the Court have held that the amounts or any money whatsoever charged for the public services are prima-facie to be excluded from the mischief of proviso to Sec. 2(15).

In Sec. 10(46) for the words "or a class thereof" at both places shall be substituted with "other than those covered under clause (46A) or a class thereof".

This amendment is with the intention to exclude income of such entities from the scope of Sec. 10(46) the new Sec. 10(46A) is inserted.

Sec. 10(46A) – Any income arising to a Body or Authority or Board or Trust or Commission, not being a company notified by Central Govt. in official Gazette, has been established for–

i) dealing with and satisfying the need for housing accommodation;

ii) planning, development or improvement of cities, towns and villages;

iii) regulating, or regulating and developing, any activity for the benefit of the general public; or

iv) regulating any matter, for the benefit of the general public, arising out of the object for which it has been created. Consequential amendment is also in explanation to nineteenth proviso of Sec. 10(23C) and similarly also in Sec. 11(7) of the Act.

J) <u>ACCRETED INCOME U/S. 115TD EVEN FOR FAILED TO APPLY FOR RE-REGISTRATION (w.e.f 01-04-2023 accordingly apply to AY 2023-24 onwards) (EXIT TAX)</u>

<u>The provisions of Sec. 115TD will also apply in following 3 more situations</u> –

i) In case where certain trusts or institutions under first and second regime have not applied for regular registration / approval after obtaining provisional registration / approval.

ii) Further some trusts or institutions under both the regime have not applied for re-registration / approval.

iii) The trusts or institutions if not applied for re-registration after the expiry of 5 years / 3 years.

The above mentioned 3 more situations are to be added so that in such situations the provisions of Sec. 115TD will apply.

CBDT Circular 06 of 2023 dated 24.05.2023 has extended certain dates for filing of 10A for re-registration & approval and for form 10AB for regular registration. Explained in details at slide no.46 & 47

K) REMOVAL OF CERTAIN FUNDS FROM SECTION 80G (w.e.f. 01-04-2024 and accordingly will be applicable for AY 2024-25 and subsequent years)

Section 80G of the Act provides for the procedure for granting approval to certain institutions and funds receiving donation and the allowable deductions in respect of such donations. The Sec. 80G (2) (a) provides a list of certain funds where the deduction is available @100% of the sum donated. In case of other trusts or institutions obtaining approval u/s. 80G where the deduction will be available the deduction @50% of the sum donated however restricted to maximum 10% of the total income.

Now it is that following three trust are omitted from the list of 100% deduction i.e. sub-clauses (ii), (iiic) and(iiid) of clause (a) of sub-section (2) of section 80G of the Act namely Jawaharlal Nehru memorial Fund, Indira Gandhi memorial trust and Rajiv Gandhi Foundation.

L) ENTITY DIGILOCKER

During the course of speech Hon'ble FM has announced that an Entity Digi Locker will be set up for use by MSMEs, large business and charitable trusts. This will be towards storing and sharing documents online securely, whenever needed, with various authorities, regulators, banks and other business entities.

Notification issued by CBDT on 21.02.2023 vide G.S.R. 118(E)

Regarding amendment in rule 16CC and rule 17B about New form of report of audit prescribed common under both the regime in new extensive form 10B & 10BB

1. Short title and commencement. —

1) These rules may be called the Income-tax Amendment (3rd Amendment) Rules, 2023.

2) They shall come into force from the 1st day of April, 2023.

2. In the Income-tax Rules, 1962 hereinafter referred to as the principal Rules, for rule 16CC, shall be substituted.

‘16CC.Form of report of audit prescribed under tenth proviso to section 10(23C).—The report of audit of the accounts of a fund or institution or trust or any university or other educational institution or any hospital or other medical institution which is required to be furnished under clause (b) of the tenth proviso to clause (23C) of section 10 shall be in-

(a) **Form No. 10B where**—

(I) the total income of such fund or institution or trust or university or other educational institution or hospital or other medical institution, without giving effect to the provisions of the sub-clauses (iv), (v), (vi) and (via) of the said clause, exceeds rupees five crores during the previous year; or

(II) such fund or institution or trust or university or other educational institution or hospital or other medical institution has received any foreign contribution during the previous year; or

(III) such fund or institution or trust or university or other educational institution or hospital or other medical institution has applied any part of its income outside India during the previous year;

(b) **Form No. 10BB in other cases.**

Explanation – Foreign contribution shall have the meaning assigned in FCRA – 2010.

3**. In the principal Rules, for rule 17B, the following rule shall be substituted, namely:—**

‘17B.Audit report in the case of charitable or religious trusts, etc.— The report of audit of the accounts of a trust or institution which is required to be furnished under sub-clause (ii) of clause (b) of sub-section (1) of section 12A, shall be in—

(a) **Form No. 10B where—**

(I) the total income of such trust or institution, without giving effect to the provisions of sections 11 and 12 of the Act, exceeds rupees five crores during the previous year; or

(II) such trust or institution has received any foreign contribution during the previous year; or

(III) such trust or institution has applied any part of its income outside India during the previous year;

(b) **Form No. 10BB in other cases.**

Explanation – Foreign contribution shall have the meaning assigned in FCRA – 2010.

(Note – Both the forms of Audit Report in form 10B & 10BB may be discussed if time permits.)

CBDT Circular 6 of 2023 dated 24.05.2023
SUMMARY

1) **Registration Provision**

(i) Application in Form No. 10A for registration / approval and Application in Form No. 10AB for approval 10(23C) (i) or re-registration 12A(1) (ac)(i) or under 80G(5)(i) of the Act, Extended till 30.09.2023

(ii) All pending applications in form 10AB with CIT (Exemp) will be considered valid applications and to be disposed off as per normal provisions.

(iii) All applications in form 10AB rejected earlier solely on account of the fact that the application was furnished after the due date, the trust may furnished a fresh application in form 10AB within the extended time i.e. 30.09.2023.

(iv) Accordingly if registration/approval is granted, the provisions of section 115TD (3) (iii) shall not apply on account of delay in making of application.

2) **Extension of due date for furnishing of Form No. 1OBD**

The due date for uploading form 10BD and issue of form 10BE F Y 2022-23 are extended from 31-5-2023 to 30.6.2023.

(There is ambiguity in extension of filing of form 10BD vis-à-vis to filing of form 10A by 30.09.2023.)

3) Clarification regarding applicability of provisional approval / registration

It is clarified that in case of trusts, funds or institutions seeking provisional approval or provisional registration, shall be effective from Assessment Year relevant to the previous year in which the application is made and shall be valid for a period of three Assessment Years subject to the provisions of 10(23C)(iii) or 12A(1)(ac)(iii) or 80G(5)(iii) of the Act, as the case may be.

4) **Clarification regarding filing of forms 9A & 10 for accumulation were required to filed by August.**

The accumulation/ deemed application shall not be denied to a trust as long as the statement of accumulation /deemed application is furnished on or before the due date of furnishing the return as provided in Sec. 139(1) of the Act. Now form 9A and 10 can be uploaded by 31st October.
Practically it is to be filed before filing of ITR since the details of accumulations are furnished in ITR and in case of belated return it is to be furnished by 31st October.

5) **Clarification regarding audit report to be furnished in Form No. 1OB & 10BB.**

It is clarified that for the purposes of form No. 10B & 10BB electronic modes referred to in para 18 are in addition to the account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

Some Important Observation
of two Supreme Court Judgments
Delivered on the same day i.e. 19.10.2022 by Three Judge Bench.

1) Ahmedabad Urban Development Authority

&

2) New Noble Education Society

Supreme Court Judgments in the case of ACIT (E) v/s. Ahemdabad Urban Development Authority and Others (2022) 143 TAXMANN.COM 278

The primary question raised before the Supreme Court

was the correct interpretation of the 1st proviso to Sec. 2(15)

of the Act inserted by Finance (No. 2) Act 2009

w.e.f. 01.04.2009

Note - For easy reference para no. in the judgment is given in bold at the end of each observation.

1) Charitable purpose [section 2(15)]

Classically, the idea of charity was tied up with eleemosynary. However, "charitable purpose" as defined in the Act has a wider meaning where the focus is on the object of the institution. Thus, *"the idea of providing services or goods at no consideration, cost or nominal consideration is not confined to the provision of services or goods without charging anything or charging a token or nominal amount"* **(para 170).**

Therefore, pure charity in the sense that the performance of an activity without any consideration is not envisioned under the Act. **[para 171]**

Proviso to Sec. 2(15)

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, 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 **twenty per cent** of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year;

2) <u>Points on Proviso to section 2(15) (As discussed in judgments)</u>

An assessee advancing general public utility cannot engage itself in any trade, commerce or business ("business, etc."), or provide service in relation thereto for any "cess or fee or any other consideration" ("fee, etc."); (**para 253A.1**)

1. The prohibition under proviso to section 2(15) applies in a four-fold manner as follows:
(a) There is a bar to engaging in business, etc.
(b) There is a bar to providing any service in relation to business etc.
(c) The bar applies if there is a fee, etc.
(d) The bar applies irrespective of the application of the income derived from such 'prohibited activities'. (**para 142**)

However, the bar does not apply if the following conditions are satisfied:
(a) the business etc. is undertaken in the course of actual carrying out of such advancement of any other object of general public utility; and
(b) the aggregate receipts from such activity or activities during the previous year do not exceed 20% of the total receipts of the assessee undertaking such activity or activities, of that previous year. (**para 136**)

3) Predominant object of activity is not relevant

In ACIT v. Thanthi Trust, (2001) 247 ITR 785 (SC) and ACIT v. Surat Art Silk Cloth Manufacturers Association, (1980) 121 ITR 1 (SC) it was held that the carrying on of business by GPU charity was permissible as long as it inured to the benefit of the trust. However, after insertion of the proviso to section 2(15), the test of the charity being driven by a **predominant object is no longer good law**. (**para 153, 167**).

4) ***Business – Meaning***

At different places in the judgment, the Supreme Court has observed as follows for deciding what constitutes or does not constitute business:

(a) **Charging of any amount which is at cost or nominally above cost, cannot be considered as business, etc. (para 173, 177, 190(v), 251, 253 A.3**)

Cost plus "nominal" mark-up does not constitute business

The Supreme Court has consistently observed that an activity which is carried on with recovery of cost plus nominal markup **never constitutes business;** It is only in the event the activity is carried on with "significant" markup that the activity would constitute business [see **para 6.2(a) and 6.2(b) in main paper**]. Hence, the proviso to section 2(15) is applicable only if there is "significant" mark-up and not when the mark-up merely exceeds nominal mark-up without reaching the threshold of significant mark-up. Between the two ends, there would be a full range of mark-up. It could be argued that in these cases, the activity does not constitute business.

(b) **It is only when the charges are markedly or significantly or vastly above the cost incurred by the assessee in question, that they would fall within the mischief of business, etc. [para 173, 190(iv)(c), 190(iv)(f), 190(v), 195 197, 251, 253 A.33, 253 E.2, 253 B.1, 253 B.2, 253 C.1, 253 C.2, 253 E.1**]

(c) If the activity involves charging of fees that are significantly higher than the cost involved **(with a nominal mark-up)** the activity would be regarded as business, etc. (**para 253 C.1**)

(d) For achieving a GPU object, if the charity involves itself in activities that entail charging amounts only at cost or marginal mark-up over cost, and also derive some profit, the prohibition against carrying on business, etc. or service relating to business is not attracted if the quantum of such profits do not exceed 20% of its overall receipts (**para 172**)

5) Cross subsidy

Statutory boards and authorities, which are under mandate to develop housing, industrial and other estates, including development of residential housing at reasonable or subsidized costs, might charge higher amounts from some section of the beneficiaries, to cross-subsidize the main activity. However, this cannot be characterized as engaging in business. (**para 144**).

6) ***Illustrations of activities constituting / not constituting business***

1) The following activities are not business:

(a) (i) Gandhi Peace Foundation disseminating Mahatma Gandhi's philosophy [example given in ACIT v. Surat Art Silk Cloth Manufacturers Association, (1980) 121 ITR 1 (SC)] through museums and exhibitions and publishing his works, for nominal cost;

(ii) Providing access to low-cost hostels to weaker segments of society, where the fee or charges recovered cover the costs (including administrative expenditure) plus nominal mark-up;

(iii) Renting marriage halls for low amounts with a fee meant to cover costs;

(iv) Blood bank services with fee to cover costs.

(**para 173**)

(b) (i) Statutory corporation supplying essential food grains at cost, or a marginal mark-up;

(ii) Supply of essential medicines by a statutory corporation;

(iii) Supply of water by a statutory corporation etc.

(**para 177**)

2) The following activities are business:

(a) When Gandhi Peace Foundation charges substantial amounts over and above the cost it incurs for

(i) doing the work referred to in para 6.5.1(a) above ; or

(ii) the work of publishing an expensive coffee table book on Gandhi.

(b) in the case of the marriage hall, significant amounts are charged from those who can afford to pay, by providing extra services, far above the cost plus nominal markup
(**para 173**)

7) Costs

For computing the costs as referred above, expenditure or costs include administrative and other costs plus a small proportion for "provision" [**para 190(v)**].

8) **Ascertainment of an activity as business, etc. or otherwise is a year to year exercise**

The claims of an organization (whether statutory or non-statutory) have to be ascertained by tax authorities on a yearly basis, and they must discern from the records, whether the fees charged are nominally above the cost, or have been increased to much higher or significantly higher levels (**para 253 E.1**). Likewise, an assessee receiving significantly high receipts is carrying on business. However, in future, if the assessee is able to satisfy that what it provides to its customers is charged on cost-basis with at the most, a nominal markup, then it may not be regarded as engaged in business (**para 253 E.1, 253 E.2 and 253 E.3**).

9) **Fee, cess or other consideration** ("fee, etc.")

The proviso applies only if the activity is carried on for fees etc. The observations of the Supreme Court in this connection are given below:

(a) The implication of the impermissibility of any trade, or commercial activity or service, as mentioned in the first part of the proviso is that the fee, etc. derived from such 'prohibited activities' is necessarily motivated by profit (**para 143)**.

(b) The ordinary meaning of fee or consideration is synonymous with something of value, usually in monetary terms. However, the use of the expression "cess" facially lends a different colour to all the three expressions. (**para 143**)

(c) "Fee, cess and any other consideration" has to receive a purposive interpretation, in the present context (**para 144)**.

(d) If fee, etc. is collected for the purpose of an activity, by a state department or an entity, set up by a statute, pursuant to its mandate to collect such fee, etc., then such an amount cannot be treated as consideration towards business, etc. The character of being 'State', and such corporations or bodies set up under specific laws (whether by States or the Centre) would, not mean that the amounts are 'fee' or 'cess' to provide some commercial or business service; (**para 144)**.

(e) The mere nomenclature of the consideration being a "fee" or "cess", is not conclusive. If the fee, etc. is to provide an essential service, in larger public interest, such as water cess or sewage cess or fee, such consideration received by a statutory body, would not be considered as towards business etc. or service in relation there to. However, the same principles do not apply to non-statutory bodies whose cases require further scrutiny (**para 144)**.

(f) The reference to fee or cess is only to emphasize that even a statutory consideration, for a service to business, etc. may take the activity outside the definition of a GPU charity; in other words, if any amount, is received for trading, or business or commercial activity, or any services in relation to such activity, then, notwithstanding their nomenclature (as fee or cess, that is, that they are fixed under a law) the GPU charity cannot claim tax exempt status (**para 151).**

(g) The expression "cess", implies a tax or impost levied for some special purpose, which may be levied as an increment to an existing tax. The term “fee”, to some extent, has a similar meaning (**para 147).**

10) Application of profits to charity

The application or “ploughing back” of amounts received in the course of business, etc. or towards services in relation thereto to feed charity is irrelevant in determining whether a business is carried on or not; this is evidenced by the term “irrespective”, in the proviso to section 2(15) (**para 151 and 167**).

Thus, the ambiguity with respect to the kind of activities generating profit which could feed the main object and incidental profit-making is no longer good law (**para 167**).

11) Conditions in proviso to section 2(15)

1. Two conditions have been introduced with respect to permissibility of carrying on business, etc.:

(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 assessee undertaking such activity or activities of that previous year.

(**para 136**)

12) Illustrations of activity in the course of actual carrying on of the activity

(a) Publication of advertisement is intrinsically linked with newspaper activity [thereby fulfilling proviso (i) to section 2(15)] that is, it is an activity in the course of actual carrying on of the activity towards advancement of the object) (para 245 & 246).

(b) Though in some instances, the recipient may be an individual business house or exporter, the following activities performed by a trade body continue to be trade promotion. Therefore, they are in the "actual course of carrying on" the GPU activity:

(i) As part of its functioning, a trade body books bulk space, which is then rented out to individual Indian exporters, which showcase their products and services, and ultimately secure export orders. Towards these services, that is, booking and providing space, rentals, which are not towards fixed assets owned by it are charged.

(ii) The skill development and diploma courses conducted by it, to improve business functioning of garment exporters, in respect of which fees are charged.

(iii) Market surveys and market intelligence, especially country specific activities, aimed at catering to specified exporters, or specified class of exporters.

(**para 204, 205**)

13) Section 11(4) and section 11(4A)

1. Section 11(4) provides that for the purposes of section 11, the words *"property held under trust" "include a business undertaking so held"* (**para 157**). Under section 11(4), it is only the business which is held under the trust that would enjoy exemption in respect of its income under section 11(1) (**para 161**). Thus, where the property held in trust, or where property settled by the donor or trust creator in favour of the trustees itself is a business undertaking, then the income from such an undertaking is covered by section 11(4). Section 11(4A) operates differently; it is applicable to cases where the trust carries on a business which is not held under trust. There is a difference between a property or business held under trust and a business carried on by or on behalf of the trust. This distinction was recognized in ACIT v. Surat Art Silk Cloth Manufacturers Association, (1980) 121 ITR 1 (SC) (**para 160**).

Section 11(4A) states that when a trust carries on a business, then unless the business is incidental or ancillary to the attainment of the objectives of the trust, it would be disentitled to an exemption under section 11(1). It imposes a further condition that separate books of accounts need to be maintained in such cases (**para 155, 160**).

2. When a business itself has been set aside for the objects of the trust, then such business is held under trust and will fall under section 11(4). However, where the profits of a business of a trust are applied for charitable purposes, then such business and trust will be governed by section 11(4A) (**para 156**).

14. Section 11(4A)

1. Section 11(4A) must be interpreted harmoniously with section 2(15), with which there is no conflict.

2. The proper way of reading reference to the term "incidental" in section 11(4A) is to interpret it in the light of proviso (i) to section 2(15), that is, the activity in the nature of business, etc. or service in relation to such activities should be conducted actually in the course of achieving the GPU object, and the income, profit or surplus or gains can then, be logically incidental. Thus interpreted, there is no conflict between the definition of charitable purpose and the machinery part of section 11(4A). Further, **the obligation under section 11(4A) to maintain separate books of account in respect of such receipts is to ensure that the quantitative limit imposed by proviso (ii) to section 2(15) can be computed and ascertained in an objective manner (para 168). In other words, once a business, etc. is carried on, separate books of accounts have to be maintained** [section 190(v), **para 253 A.4**].

The insertion of section 13(8), seventeenth proviso to section 10(23C) and third proviso to section 143(3) (all w.e.f. 01.04.2009), reaffirm this interpretation and bring uniformity across the statutory provisions (**para 253 A.4**).

3. If a property is held under trust and such property is business, the case would fall under section 11(4) and not under section 11(4A) (**para 160**).

4. Section 11(4A) applies to

(a) profits of a business of a trust which

(i) are applied for charitable purpose (**para 155/156/163**); or

(ii) is carried on by or on behalf of the trust (**para 160**).

(b) a case where business is not held under trust (**para 160**).

15) Section 10(23C)

1. It is necessary in each case, having regard to the first proviso and seventeenth proviso to section 10(23C), that the authority considering granting exemption, takes into account the objects of the enactment or instrument concerned, its underlying policy, and the nature of the functions, and activities, of the entity. If in the course of its functioning it collects fees, or any consideration that merely cover its expenditure (including administrative and other costs plus a small proportion for "provision"; such amounts are not consideration towards business, etc. or service in relation thereto. However, amounts which are significantly higher than recovery of costs, have to be treated as receipts from business, etc.. It is for those amounts, that the quantitative limit in proviso (ii) to section 2(15) applies, and for which separate books of account will have to be maintained [**para 190(v)**]

2. *7th proviso to section 10(23C)*

The seventh proviso carves out an exception to the exemption such that income derived by charities from business is not exempt. It virtually echoes section 11(4A) in that business income derived by a charity which arises from an activity incidental to the attainment of its objective is not per se excluded (**para 169)**.

3. The conditions in section 10(23C) have to be fulfilled before an assessee can qualify for exemption under section 10(23C) (**para 169**).

16) Principles of interpretation laid down by the Supreme Court

1. ***Statement of objects and record or notes on clauses***
The Court is required to first look at the statement of objects and reasons or notes to clauses before resorting to surrounding circumstances (such as history, etc.) (**see para 107**).

2. ***History of the legislation***
Courts can look at the previous history of the statute, and the changes it underwent to discern what is intended by the lawmakers when an amendment is introduced, or a new law enacted (**para 111**).

3. ***Speeches in Parliament***
Speeches made in the legislature or Parliament, can be looked into for throwing light on the rationale for an amendment. There is some authority for that proposition. Some light can be discerned from the statement of the finance minister on the floor of Parliament, who answered to the criticism levelled against the change brought about by the amendment in 2008 (**para 112**).

4. ***Circulars issued by the CBDT***

The views expressed in Keshavji Ravji & Co. v. CIT 1992 (2) SCC 231, CC v. Indian Oil Corporation 2004 (2) SCR 511 and CCE v. Ratan Melting and Wire Industries 2008 (13) SCC 1, reflect the correct position, that is, the circulars are binding upon departmental authorities, if they advance a proposition within the framework of the statutory provision. However, if they are contrary to the plain words of a statute, they are not binding. Furthermore, they cannot bind the Courts, which have to independently interpret the statute, in their own terms. At best, in such a task, they may be considered as departmental understanding on the subject and have limited persuasive value. At the highest, they are binding on tax administrators and authorities, if they accord with and are not at odds with the statute; at the worst, if they cut down the plain meaning of a statute, or fly on the face of their express terms, they are to be ignored (**para 123**).

NEW NOBLE EDUCATIONAL SOCIETY V. CCIT, (2022) 143 TAXMANN.COM 276 (SC)

There were two primary questions before the Supreme Court

I) What constitutes solely for educational purposes and not for purpose of profit

II) Whether the Charitable Institutions ought to be registered under mandatory local laws for charities

Note - For easy reference para no. in the judgment is given in bold at the end of each observation.

1) Introduction –

1. There has been a huge controversy on what constitutes, '*solely for educational purposes and not for purposes of profit',* for the purpose of section 10(23C). Recently, in New Noble Educational Society and Others , the Supreme Court consolidated 5 appeals and has pronounced a judgment interpreting the said expressions and some other provisions.

2. The subject matter of the appeals before the Supreme Court was the rejection of the appellants' claim for approval as a fund or trust or institution or any university or other educational institution (hereinafter collectively referred to as "institution / trust") under section 10(23C). The Andhra Pradesh High Court, by its detailed impugned judgment

a) held that the appellant trusts which claimed benefit of exemption under section 10(23C) were not created 'solely' for the purpose of education, and that to determine that issue, the Court had to consider the memorandum of association or the rules or the constitution of the concerned trust.

b) denied registration to the appellants on the ground that they were not registered under the Andhra Pradesh Charitable and Hindu Religious Institutions and Endowments Act, 1987 (hereinafter, "A.P. Charities Act") as condition precedent for grant of approval.

(para 2)

2) <u>'Education' under section 2(15)/10(23C):</u>

(a) It is not the broad meaning of the expression "education" which is involved in section 10(23C).

(b) Having regard to Loka Shikshana Trust v. CIT, [1975] 101 ITR 234 (SC), education in the definition of charitable purpose in section 2(15) is imparting formal scholastic learning, (**para 33**)

(c) The Court has to consider the objects of an institution to determine whether it is engaged in education or not, following Aditanar Educational Institution v. ACIT, (1997) 224 ITR 310 (SC) [**para 48(ii)]**

3) <u>Institution should be engaged in education</u>

The applicant institution should itself be engaged in imparting education, if it claims to be part of an entity or university engaged in education. In Oxford University Press v. CIT, (2001) 247 ITR 658 (SC), the applicant was a publisher, part of the Oxford University established in the U.K. It did not engage in imparting education, but only in publishing books, periodicals, etc. for profit.

The Court held that the mere fact that it was part of a university (incorporated or set up abroad) did not entitle it to claim exemption on the ground that it was imparting education in India.[**para 48(iii**)]

4) <u>Meaning of 'solely for educational purposes' in section 10(23C)</u>

(a) The exemption is available if the institution exists *'solely for educational purposes and not for purposes of profit'.* This requirement is categorical. While construing this essential requirement, the seventh proviso, which carves out the exception, to a limited extent, cannot be looked into. (***para 50***)

(b) A charitable institution may not by itself carry on educational activities; however, if it sets up and governs educational institutions, and the sole object of the charitable institution is education, it would be regarded as a charity set up solely for the purpose of education. [following Aditanar Educational Institution v. ACIT, (1997) 224 ITR 310 (SC)] [**para 40 and 48(i**)]

(c) The expression 'solely' had been interpreted, as the 'dominant / predominant /primary/ main' object [American Hotel & Lodging Association, Educational Institute v. CBDT (2008) 301 ITR 86 (SC); Queens Education Society v. CIT (2015) 372 ITR 699 (SC)]. However, the plain and grammatical meaning of the term 'sole' or 'solely' is 'only' or 'exclusively'. Hence, the term 'solely' is not the same as 'predominant / mainly'. The term 'solely' means to the exclusion of all other. Having regard to this meaning, an institution cannot have objects which are unrelated to education. In other words, all objects of institution must relate to imparting education or be in relation to educational activities or facilitating education. [**para 48(v), 50, 51 and 76(a**)]

(d) The judgments in American Hotel (supra) as well as Queens Education Society (supra) as to the meaning of the expression 'solely' are erroneous and are accordingly overruled to that extent. [**para 60 and 76(e)**]

5) **<u>Meaning of "not for the purposes of profit":</u>**

(a) Where the objective of the institution appears to be profit-oriented, such an institution would not be entitled to approval under section 10(23C). At the same time, surplus accruing in a given year or set of years per se, is not a bar, provided such surplus is generated in the course of providing education or educational activities. [**para 76(b)]**

(b) The seventh proviso to section 10(23C)(vi) alludes to business and profits *('being profits and gains of business, unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business).* The said proviso is an exception to the rule that the institution should not exist for the purposes of profit (**para 58**)

6) <u>Seventh proviso to section 10(23C)</u>

(a) According to section 10(23C), the trust or educational institution must not exist for profit. The seventh proviso, however, permits the trust or institution to record (or earn) profits, provided the 'business' (which has to be read as the education or educational activity) is incidental to the attainment of its objectives that is, the objectives of, or relating to, education (para 58) and separate books of accounts are maintained (para 60). It is only in those circumstances that 'business' income can be permitted (**para 60**).

(b) The seventh proviso to section 10(23C), is applicable only to those institutions which impart education or are engaged in activities connected to education. [**para 76(c)]**

(c) The reference to 'business' and 'profits' in the seventh proviso to section 10(23C) merely means that the profit of a business which is 'incidental' to educational activity – that is, relating to education such as sale of text books, providing school bus facilities, hostel facilities to students, etc. [**para 76(d)**]

7) **<u>Meaning of "incidental"</u>**

'Incidental', in the context of the present case, means something connected with or relating to the activity of education. [**para 59, para 76(c), para 76(d)]**

8) <u>Illustrations of activities 'incidental' to education</u>

The following activities of an educational institution could be regarded as incidental to providing education.

(a) If a State established institution published and sold text books, such activity was included in education (as held in Assam State Text Books Production and Publication Corporation Ltd. v. CIT, (2009) 17 SCC 39

(b) Running own buses and providing bus facilities to transport children (**para 72**)

(c) Organizing summer camps for pupils (**para 72**)

(d) Special educational courses, such as relating to computers etc., which may benefit its pupils in their pursuit of learning. (**para 72**)

(e) Providing hostel and allied facilities (such as catering etc.) only to its students. (**para 74**)

9) <u>Illustrations of activities 'not incidental' to education</u>

(a) Educational institutions providing their premises or infrastructure to other entities, trusts, societies etc., for the purposes of conducting workshops, seminars, or even educational courses (which the concerned institution is not actually imparting) and outsiders being permitted to enrol in such seminars, workshops, courses etc. (**para 73**)

(b) Providing hostel and allied facilities (such as catering etc.) to outsiders also (**para 74)** The income derived from such activity cannot be characterised as part of education or 'incidental' to the imparting education. Such income can properly fall under the other heads of income. (**para 73**)

10) <u>Registration: (Applicability of other laws)</u>

(a) The requirement of registration of every charitable institution under mandatory local laws such as Andhra Pradesh Charities Act is not optional. Aside from the fact that the consequences of non-registration are penal, which indicates the mandatory nature of the provisions of the A.P. Charities Act, such local laws provide the regulatory framework by which annual accounts, manner of choosing the governing body (in terms of the founding instrument: trust, society, etc.), acquisition and disposal of properties, etc. are constantly monitored (**para 69**).

Hence, wherever registration of trust or charities is obligatory under State or local laws, the concerned assessee seeking approval under section 10(23C) should also comply with provisions of such state laws. This would enable the Commissioner to ascertain the genuineness of the trust, society etc.[**para 76(g)**]

(b) Charitable institutions, which may be regulated by other State laws have to comply with them; they also have to comply with laws regulating education (at all levels). Compliance with or registration under those laws is also a relevant consideration which can legitimately weigh with the Commissioner or other concerned authority, while deciding applications for approval under section 10 (23C). (**para 70**)

11) <u>Applicability to other sub-clauses of section 10(23C)</u>

The main provision in section 10(23C) spells out the conditions for exemption under section 10(23C); the same conditions apply equally to other sub-clauses of section 10(23C) which deal with education, medical institution, hospitals, etc. (**para 71**)

12) <u>Taxation of income which is not from educational activities</u>

Income which is not from educational activities or is not "incidental to imparting education" is to be taxed under other heads of income – **para 73**

13) <u>Prospective</u>

The law declared in the present judgment shall operate prospectively (**para 78**)

<u>ANALYSIS OF THE OBSERVATION OF THE SUPREME COURT</u>

14) <u>Education (para 2)</u>

In Loka Shikshana Trust (supra) the Supreme Court observed that: *What education connotes in that clause is the process of training and developing the knowledge, skill, mind and character of students by formal schooling.* In the instant case, the Supreme Court understood the said observations as imparting "formal scholastic education". It is submitted that the said understanding of the Supreme Court has not changed the legal interpretation by Loka Shikshana in any manner:

(a) The Supreme Court summarized in one expression the observations/conclusion in Loka Shikshana case; such summary cannot lead to any change in the principles laid down in Loka Shikshana's case.

(b) In the instant case, the Supreme Court used the expression "formal scholastic education"; the word 'formal' was also used in Loka Shikshana case. While Supreme Court judgment is not a statute and words cannot be picked up and interpreted with the aid of dictionary, [CIT v. Sun Engineering Works (P) Ltd, (1992) 64 Taxman 442 (SC), Bharat Petroleum Corporation Ltd. v. N. R. Vairamani, (2004) 8 SCC 579; P.S. Sathappan v. Andhra Bank Ltd., (2004) 11 SCC 672] the meaning of the words "schooling" and "scholastic" used by the Supreme Court are as follows:

15) <u>Solely for educational purposes in section 10(23C) (para 4)</u>

1. Apart from section 10(23C)(vi), the expression "solely" also appears in the following sub-clauses of section 10(23C)

(a) sub-clause (iiiab) (educational institution substantially financed by the Government).

(b) sub-clause (iiiad) (educational institution with receipts lower than the specified threshold)

(c) sub-clause (iiiac) (hospital, etc. substantially financed by the Government)

(d) sub-clause (iiiac) (hospital, etc. with receipts lower than the specified threshold)

(e) sub-clause (via) (any other hospital, etc. approved by the specified authority).

It appears that the interpretation given by the Supreme Court to the expression "solely" will also apply to the said expression in the aforesaid sub-clauses.

2. The Supreme Court has held that all the objects have to be for educational purpose and even if there is one object for non educational purpose, the institution will not be eligible for relief under section 10(23C). In other words, if the income of the educational institution can be validly diverted, under its objects, for any other use or purpose, then it cannot be said to be for solely for educational purposes for section 10(23C)

In the following instructions/judgments also it was held that all objects have to be educational purposes.

(a) See Instruction No. 1112 [F.No. 194/16-17-IT(A-I)] dated 29.10.1977

(b) Birla Vidhya Vihar Trust v. CIT, (1982) 136 ITR 445 (Cal);

(c) Sree Chithra Educational Cultural and Film Society v. DDIT(E), (2019) 104 taxmann.com 433 (Ker) , para 15 (specially when the assessee has declared income from cultural activities);

(d) B.S. Abdur Rahman Institute of Science & Technology v. CCIT, (2017) 78 taxmann.com 336 (Mad), para 11 ;

(e) Xavier's Institute of Management v. State of Orissa, (2013) 33 taxmann.com 376 (Ori), para 53

(f) R. R. M. Educational Society v. CCIT, (2011) 339 ITR 323 (AP), para 14 ;

(g) Aurora Educational Society v. CCIT, (2012) 20 taxmann.com 46 (AP) , para 10.15, 10.16 and 10.23;

3. It is pertinent that the Supreme Court has observed that all the objects should be aimed at imparting or **facilitating** education or **be in relation to education activities [para 51 and 76(a)].**

Hence, the condition that the institution exists solely for educational purposes is satisfied even if some objects are for facilitating education or in relation to educational activities and not directly for imparting education.

4. The Supreme Court judgment practically stops educational institutions from performing any other charitable work: To illustrate, suppose there is a famine/drought. To help in such situations, the object should authorize such institutions to help. If the object permits, then as per the judgment, it is not solely education, and if it is not mentioned in the objects, it would be breach of trust for a trustee even if donation is made to PM Cares or Prime Minister's Drought Relief Fund etc.

16) <u>Not for the purposes of profit (para 5)</u>

1. The Supreme Court has equated the expression "not for the purposes of profit" with "not being profit oriented". It has not elaborated the meaning of the said expression. In online dictionaries the term has been defined as follows:

(a) *Concerned with or focused on financial gain; commercial*

(b) *Functionally directed*

(c) *Mainly concerned with, or directed towards, a particular group, activity, or situation*

(d) *Showing the direction in which something is aimed: She wants to turn the company into a profit-oriented organization*

Thus, essentially "profit oriented" means focused on or concerned with or directed towards financial gain. Hence, if the education institution is focused on, or concerned with, financial gain, then it cannot be regarded as an institution "not for the purposes of profit". [subject to exception in seventh proviso to section 10(23C)]

2. Even if a society / trust is created with the sole object to advance the cause of education but if such object is coupled with the orientation to earn profits, then such institution will not be entitled to exemption under section 10(23C).

3. The Supreme Court has held that the educational institution may carry on incidental business as long as the conditions in seventh proviso are fulfilled. Thus, an educational institution has to exist solely for educational purposes but that does not mean that ancillary activities, which help the institution attaining the main object, cannot be carried out.

17) *Cost plus significant markup test is not applicable*

In ACIT(E) v. Ahmedabad Urban Development Authority and Others, (2022) 143 taxmann.com 278 (SC), for the purpose of the Supreme Court held that whether an assessee is carrying on business or not has to be evaluated on the basis of cost plus significant markup test, that is, if the price charged by the assessee is cost plus significant markup then, it could be regarded as carrying on business. In the instant case, no such test has been laid down by the Supreme Court. In fact, the Court has suggested that at the stage of registration, the 'proportion of income' or surplus or profits generated from such objects is not very relevant [see **para 63(SC)**]. It appears that the said test cannot be straightaway applied to section 10(23C) especially because the words for interpretation are different in the proviso to section 2(15)("business") and section 10(23C) ("not for purposes of profit")

However, please see Fernandez Foundation v. CIT, 2022 (12) TMI 635 - ITAT HYDERABAD, where the Tribunal has, in the context of hospital, held that the assessee was not satisfying the meaning of charitable purpose since, inter alia, the assessee has not demonstrated that it was charging reasonable mark-up. The Tribunal has not discussed the "profit oriented test".

18) <u>It has been held that an institution is existing for profit in following situations:</u>

a) an educational institution engaged in commercial or profit making activities

(i) Oxford University Press v. CIT, (2001) 247 ITR 658 (SC), para 25;

(ii) R. R. M. Educational Society v. CCIT, (2011) 339 ITR 323 (AP), para 11

(iii) Sahara Educational Society v. DIT(E), (2014) 42 taxmann.com 171 (Hyd Trib), para 24;

(iv) See DCIT v. JMJ Education Society, 2021 (5) TMI 381 - ITAT BANGALORE (an activity cannot be regarded as education if the assessee is carrying on a commercial venture) (held, on facts in favour of the assessee)

b) Huge surplus in publication of books up to secondary level, publication of syllabus for various classes and conduct of examination at various levels

Himachal Pradesh Board of School Education v. ITO, (2013) 38 taxmann.com 197 (Chd Trib), in the context of section 10(23C)(iiiab)

c) Huge surplus

The assessee was earning huge profit which financial year 2008-09 was ` 1997.11 lacs. The Tribunal held that since huge surplus had been generated by the assessee, it could be said that the profit motive of the assessee was clearly established [M.P. Rajya Open School Bhopal v. DCIT, (2013) 141 ITD 721 (Indore)]

d) Increasing surplus plus high fee structure

DCIT v. Malout Institute of Management & Information Technology, (2014) 43 taxmann.com 228 (Asr Trib)

e) Huge profits year after year with surplus between

(i) 30% and 42%
Indian Institute of Engg Technology v. DDIT(E), (2018) 96 taxmann.com 78 (Chny Trib), para 7

(ii) 44.6% and 48.43%
IILM Foundation v. ADIT(E), 2017 (11) TMI 638 – ITAT Delhi, para 7.4

(iii) 54.5% and 64.64%
Visvesvaraya Technological University v. ACIT, (2014) 362 ITR 279 (Kar)

f) Systematically generating huge surplus year after year as found during search Bhupesh Kumar Sikshan Evam Vikas Sansthan v. DCIT, (2015) 57 taxmann.com 326 (Patna)] [in the context of section 10(23C)(vi)]

g) Capitation fees

i) If an education institution charges capitation fees, it could be construed as not existing solely for education purposes but for profit. [Oasis Educational Society v. ADIT, (2010) 132 TTJ 59 (Hyd) (UO), para 9].

ii) If any amount is received by the assessee over and above fee fixed by the committee as directed by the Supreme Court in P.A. Inamdar v. State of Maharashtra [2005] 6 SCC 537; it has to be classified as capitation fees and in such a situation the assessee exists for profit and not solely for educational purpose [Vodithala Education Society v. ADIT(E), (2008) 20 SOT 353 (Hyd), **para 20**].

iii) CIT v. MAC Public Charitable Trust, TS-837-HC-2022 (MAD)

It appears that the same principle would apply after the Supreme Court judgment in the instant case, and the assessees with facts similar to those in the above cases may be regarded as "profit oriented" and may not be entitled to exemption under section 10(23C).

19) <u>Illustrations of situations in which an institution could not be regarded as existing for purposes of profit</u>

In the following cases, it was held that the institution did not exist for profit

(a) **<u>Interest income</u>**
If the major reason for surplus is interest received by the assessee on invested funds, then it does not mean that the institution is "for profit" [A.R.R. Trust v. ACIT, (2005) 97 ITD 203 (Chny), **para 17**; DCIT v. Nehru Prasutika Asptal Samiti, (2013) 145 ITD 8 (Agra)].

(b) **<u>Accumulation of income by institution does not mean that it is not eligible for exemption</u>**
Merely because an educational institution accumulates income, it does not go out of consideration of section 10(23C)(iiiab). It goes out only if application of income is for the purposes other than education since the institution is to be established and maintained solely with the object of imparting education [Maa Saraswati Educational Trust v. UOI, (2013) 353 ITR 312 (HP), **para 7**].

(c) Mere sale of uniforms and books only to the students of the school of the appellant, not to outsiders, at lower rates compared to market rates but resulting in surplus does not make it activity for profit [New Amazing Shiksha Society v. ITO(E), (2019) 104 taxmann.com 164 (Del Trib), **para 8**].

It appears that the ratio of the aforesaid decisions continue to apply even after the Supreme Court judgment in the instant case.

20) In American Hotel and Lodging Association Educational Institute v. CBDT, (2008) 10 SCC 509, [followed in Venu Charitable Society v. DGIT, (2017) 80 taxmann.com 57 (Delhi), para 16] it was observed as follows:

"In order to ascertain whether the institute is carried on with the object of making profit or not it is the duty of the prescribed authority to ascertain whether the balance of income is applied wholly and exclusively to the objects for which the applicant is established."

Again in Queen's Educational Society v. CIT, (2015) 372 ITR 699 (SC), it was observed as follows:

"(vi) The final conclusion that if a surplus is made by an educational society and ploughed back to construct its own premises would fall out of section 10(23-C) is to ignore the language of the section and to ignore the tests laid down in Surat Art Silk Cloth case [CIT v. Surat Art Silk Cloth Manufacturers' Assn. (1980) 2 SCC 31], Aditanar case [Aditanar Educational Institution v. CIT [(1997) 3 SCC 346] and American Hotel & Lodging case [American Hotel & Loding Association Educational Institute v. CBDT [(2008) 10 SCC 509"

The Supreme Court, in the instant judgment has not commented on the above test. Further, the Supreme Court has categorically observed that the reasoning and conclusion in the aforesaid judgments are disapproved so far as they pertain to the interpretation of the expression "solely" and the judgments are accordingly overruled to that extent [**para 76(e)(SC**)]. Hence, while it is not clear, it could be argued that the aforesaid test of application may still be relevant.

21) It has also been held that merely because the institution has surplus does not mean that it exists for profit and not solely for educational purposes, so long as

(a) no person or individual was entitled to any portion of the said profit ; and

(b) the profit was not utilised for the purpose other than for promotion of the objects of the society

(c) the profit is not distributed to private individuals.

(d) the surplus arising incidentally or on account of incidental activities

Please see:

(i) Visvesvaraya Technological University v. ACIT, (2016) 384 ITR 37 (SC), (During a short period of a decade i.e. from the year 1999 to 2010 the appellant University had generated a surplus of about ` 500 crores, by realizing fees under different hands. The difference between the fees collected and the actual expenditure incurred for the purposes for which fees were collected was significant. The surplus accumulated over the years had been ploughed back for educational purposes. In such a situation, it was held that the appellant University existed "solely for educational purposes and not for purposes of profit").

The review petition against the aforesaid judgment has been dismissed [Visvesvaraya Technological University v. ACIT, (2016) 73 taxmann.com 286 (SC)] ;

(ii) CCIT v. St. Peter's Educational Society, (2016) 70 taxmann.com 171 (SC);

(iii) American Hotel & Lodging Association Educational Institute v. CBDT, (2008) 301 ITR 86 (SC), para 29;

(iv) Aditanar Educational Institution v. ACIT, (1997) 224 ITR 310 (SC), affirming ACIT v. Aditanar Educational Institution, (1979) 118 ITR 235 (Mad);

(v) DIT(E) v. Delhi Public School Society, (2018) 92 taxmann.com 132 (Del), para 22, SLP dismissed in DIT(E) v. Delhi Public Schools Society, (2018) 100 taxmann.com 80 (SC)

(vi) St. Lawrence Educational Society (Regd.) v. CIT, (2013) 353 ITR 320 (Del) approved in Taparia Tools Ltd. v. JCIT, (2015) 55 taxmann.com 361 (SC)

(vii) CIT(E) v. Deccan Education Society, (2019) 101 taxmann.com 310 (Bom);

(viii) Mallikarjun School Society v. CCIT, (2018) 90 taxmann.com 160 (Uttarakhand) (reinvestment of surplus in infrastructure) ;

(ix) See Orissa Trust of Technical Education and Training v. CCIT, (2012) 24 taxmann.com 202 (Ori), para 13;

(x) CIT v. Aggarwal Sabha Maharaja Aggarsain Bhawan, (2011) 9 taxmann.com 291 (P&H);

(xi) Maa Saraswati Educational Trust v. UOI, (2013) 353 ITR 312 (HP), para 7;

(xii) Gujarat State Co-Operative Union v. CIT, (1992) 195 ITR 279 (Guj);

(xiii) CIT v. Academy of General Education, Manipal, (1984) 150 ITR 135 (Kar), para 11;

(xiv) Governing Body of Rangaraya Medical College v. ITO, (1979) 117 ITR 284 (AP)

(xv) Sree Kanya Pathsala trust v. UOI, (2014) 360 ITR 60 (Gau), para 12;

(xvi) CBDT Circular No.14/Bang/2015 dated 17/08/2015 explained in DCIT(E) v. Mahatma Gandhi Vidyapeetha Trust, 2019-TIOL-990-ITAT-Bang [mere generation of surplus by educational institution cannot be basis to reject application under section 10(23C)(vi)];

Now, in the instant case, the Supreme Court has also observed that surplus in a given year or set of years per se, is not a bar, provided such surplus is generated in the course of providing education or educational activities [**para 76(b) (SC)].**

It appears that mere generation of surplus year after year would not mean that the institution is profit oriented. It is a factual matter as to whether it is “profit oriented” and this would depend on the extent of surplus

22) *Computation of profit*

It has been held that in determining the surplus the following have to be reduced:

(a) **Depreciation**
Manas Sewa Samiti v. CCIT, (2015) 65 taxmann.com 30 (All), **para 14**

(b) **Expenditure towards objects of the institution**
The surplus should be calculated after reducing the receipts by the expenditure incurred towards activities to attain the objects [Arvind Bhartiya Vidhyalya Samiti v. ACIT, (2008) 115 TTJ 351 (Jpr)].

(c) **Capital expenditure**
In calculating the surplus, capital expenditure needed for educational activity of the institution has to be reduced [see Gyani Inder Singh Human Development & Educational Society v. DCIT, (2014) 39 CCH 039 DelTrib, **para 2.5**] [investment in various assets including building account, land account, water cooler, water lift, furniture and fixture, computer and accessories, library books, library equipments, gardening equipments and fire extinguishers etc.].

The aforesaid approach is also in line with the third proviso to section 10(23C) under which capital expenditure would be regarded as application of income for assessees covered by section 10(23C)(iv) to section 10(23C)(via).

23) It has also been held that when a surplus is ploughed back for educational purposes, the educational institution exists solely for educational purposes and not for purposes of profit.

24) *"Reasonable surplus" is permissible*

While the object of establishing an educational institution should not be to make profit there can, however, be a "reasonable revenue surplus" which may be used by the educational institution for the purpose of development of education and expansion of the institution [T. M. A. Pai Foundation v. State of Karnataka, AIR 2003 SC 355 (seven judges bench, in the context of Article 19(1)(g) of the Constitution of India); Aurora Educational Society v. CCIT, (2011) 339 ITR 333 (AP), **para 10.23**; New Noble Educational Society v. CCIT, (2011) 334 ITR 303 (AP)]

25) *Surplus cannot be more than 10% - 15%*

(a) The word "surplus" will have to be read and understood in proper perspective. It cannot be more than 10% - 15% so as to meet contingencies or unforeseen expenditure [Visvesvaraya Technological University v. ACIT, (2014) 362 ITR 279 (Kar), para 37]. However, see Visvesvaraya Technological University v. ACIT, (2016) 384 ITR 37 (SC), where the Court observed that the surplus generated was far in excess of what was held by the Court to be permissible (6 to 15%) in Islamic Academy of Education and another vs. State of Karnataka and others, (2003) 6 SCC 697. It also observed that the percentage of surplus in Islamic Academy of Education (supra) was in the context of the determination of the reasonable fees to be charged by private educational bodies and ultimately held that the appellant existed "solely for educational purposes and not for purposes of profit".

The review petition against the aforesaid judgment has been dismissed [Visvesvaraya Technological University v. ACIT, (2016) 73 taxmann.com 286 (SC)].

(b) While this Court has not laid down any fixed guidelines as regards fee structure, a reasonable surplus should ordinarily vary from **6% to 15%,** as such surplus would be utilized for expansion of the system and development of education. [TMA Pai, Islamic Academy of Education v. State of Karnataka, (2003) 6 SCC 697 cited in Visvesvaraya Technological University v. ACIT, (2014) 362 ITR 279 (Kar), para 44].

(c) Surplus of 12.12% which is less than 15% is legitimate for charitable purpose [New Amazing Shiksha Society v. ITO(E), (2019) 104 taxmann.com 164 (Del Trib), **para 8**] .

26) *Surplus from 15% to 20 %*

It could be argued that a slight increase over the 15% limit cannot trigger a loss of exemption under section 10(23C)(iiiab). Thus, an institution generating surplus of over 15% to 20% cannot be characterized as a profiteering institution when the surplus generated by the institution was being utilized only for the development of the school [Malco Vidyalaya Matriculation Higher Secondary School v. CCIT, (2019) 103 taxmann.com 104 (Mad)].

27) Third proviso to section 10(23C) stipulates that the assessee should apply atleast 85% of its income wholly and exclusively towards its objects. It could be argued that this percentage is a good limit as to how much surplus (after considering capital expenditure) can be legitimately made by the assessee. [also see Pragathi Nagar Educational Society v. DIT(E), 2013 (10) TMI 1077 - ITAT Hyderabad]

28) *Other evidences*

While the Supreme Court has focused on the 'profit-oriented' test, it appears that in a borderline situation, the following evidence may help in showing that the activity is not for profit.

(a) Board Resolution by trustees / directors

(b) Corroborative narration on the website

(c) Director's report

(d) Certificates / letters of appreciation from the Government / authorities

(e) Fees charged by the charitable institution, as compared to fees charged by other comparable schools.

29) *Educational institutions governed by section 11*

Many educational institutions opt to be governed by section 11 and not section 10(23C). To such assessees, the definition of charitable purpose in section 2(15) is applicable: the said definition does not use the term "solely". Further, the expression "not for the purpose of profit" is not found in section 2(15). Hence, the interpretation of "solely" or "not for the purposes of profit", that is, not being profit oriented, as laid down by the Supreme Court in the instant case is not applicable to section 2(15).

30) Exemption under section 10(23C): whether should be evaluated every year ?

Courts have held as follows:

The availability of the exemption under section 10(23C) should be evaluated each year at assessment stage to find out whether the conditions are fulfilled or not

Consistency to be observed by AO

(a) At the same time, if the assessee has been allowed exemption under section 10(23C) for the past many years then in the absence of any change in the objects and activities of the assessee, the AO is not justified in taking a different view only in respect of the present assessment year:`

31) **Consequences of institution not being solely for educational purpose or being "profit oriented"**

(a) The institution will not be eligible to exemption under section 10(23C).

(b) In certain cases (say, collection of capitation fees) the activities of the institution may be regarded as not being genuine and shall result in specified violation under Explanation 2 to fifteenth proviso to section 10(23C) and possible cancellation of approval, followed by exit tax under section 115TD of the Act.

(c) If the business is not incidental to the attainment of the objects of the institution or the institution has failed to maintain separate books of accounts for such business (seventh proviso), then it shall result in specified violation under Explanation 2 to fifteenth proviso to section 10(23C) and possible cancellation of approval, followed by exit tax under section 115TD of the Act.

32) **Registration or approval (para 11)**

The Supreme Court has categorically held that the charitable institution ought to be registered under mandatory local laws for charities.

Even in a case where a Society Registered u/s. 43 of A. P. Charitable & Hindu Religious and Endowment Act, 1987, the AO is not absolved of his statutory duties to satisfy himself that the applicant society is not only a charitable institution but also that its charitable objects are exclusively for educational purposes and not for other purpose.

Charitable institutions have to comply with all laws regulating education (say, Right to Education Act). A variation of this principle is now found in Explanation 2 to fifteenth proviso to section 10(23C)

33) Rectification / reassessment is not possible for past years

1. The Supreme Court has categorically held that the judgment shall apply prospectively and hence, it will not apply to the period up to the assessment year 2022-23; such assessments cannot be completed on the basis of the Supreme Court judgment or be reopened under section 147 or rectified under section 154.

2. In view of the above clarification of the Supreme Court, the High Court has held that in an appeal for a prior year, the Revenue cannot take advantage of the changed legal position as a result of the Supreme Court decision [CIT v. Sikhya 'O' Anusandhan, TS-04-HC-2023(ORI)].

3. So far as assessment year 2023-24 is concerned, it appears that the law laid down by the Supreme Court shall not apply for following reasons:

(a) the judgment was pronounced on 19th October 2022. If it is made applicable to assessment year 2023-24 (that is, financial year 2022-23), it is in effect retrospective, because it would then affect the period from 1st April 2022 to 19th October 2022. Such an interpretation goes contrary to the Supreme Court observation that the judgment applies prospectively.

(b) In the past, suppose an assessee was getting exemption under section 10(23C) on the basis of precedents, including those of the Supreme Court. Now, the judgment would entail change in objects or change in the manner a charitable institution is charging fees and earning revenues. These changes require reasonable time which is also noted by the Supreme Court in **para 78** and hence, considering this, the judgment should not apply to the period up to 31st March 2023.

34) Suggested way forward for charitable institutions

(a) Check whether the objects clause in the trust deed/memorandum of association of the charitable institution contains any "non-educational objects."

(b) Check whether the institution could be regarded as "profit oriented."

(c) If the answer to any one of the questions (a) or (b) above is yes, consider whether the assessee can switch to be governed by section 11 [see section 11 (7)]

(d) If the assessee wishes to continue to avail of exemption under section 10(23C), initiate steps to change the objects.

(e) Write to the Jurisdictional CIT/Assessing Officer that steps have been initiated for changing objects. (see para 2.6.2)

(f) If the assessee can be regarded as "profit oriented", consider reduction in fees charged or giving more concession to deserving students.

- THANK YOU –

-CA. VIPIN BATAVIA-

GMAIL – **vipinbataviaca@gmail.com**