



RATIONALE FOR JUSTIFICATION FOR INCOME-TAX EXEMPTIONS FOR EDUCATIONAL INSTITUTIONS: A STUDY

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i) ABSTRACT

This research study relates to the justification for Income-Tax exemptions in favour of educational institutions. This study assumes considerable significance in the context of growth of educational institutions of varied types. The relevant provisions of the Income-Tax law has been analysed and examined. The determination of the charitable purpose in contra distinction to the profit making motive has been studied. The various tests laid down by the courts to determine the true nature of educational / charitable character of the institution has been dealt with in greater detail in the light of various decisions of the apex court as well as High Courts of judicature. Various suggestions have been made in particular for the simplification of existing provisions.

ii) Key words

- a) charitable purpose and educational purpose*
- b) profit-making motive*
- c) standardised form*
- d) CSR activities*
- e) Swachh Bharath*

iii) Introduction

1. In the recent years, there has been a tremendous growth of various types of educational and training institutes including coaching centres which are earning huge profits in the name of collection of fees towards various

purposes like, tuition fees, supply of uniform and books and others which has almost become exorbitant undermining the quality of education. In some of the institutions, there exists no proper facilities, ill-maintained libraries and staff employed on part-time or contract basis and not many faculties (below what is required) saving lot of money. It has been alleged that there are no proper accounts of income and expenditure and income earned is used for purposes other than the purpose for which the institution has been established. The sole aim in establishing institution is to claim exemptions available under income-tax law and to earn profits under the colour of carrying on activities for imparting education or a charitable purpose. In this context a reference can be made to what constitutes a charitable purpose for the purposes of income-tax by adverting attention to (Sec 10(23-C) (iii)ad)¹ which states thus:-

Sec 10: Income not included in total income

In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included –
(23-C) any income received by a person on behalf of – (iii)ed any university or other educational institution existing solely for educational purposes and not for purposes of profit, if the aggregate annual receipt of such university or educational institution does not exceed the amount of annual receipts as may be prescribed.

Rule 2CA framed prescribes an amount of one crore.

iv) Text of the Research Article

2. The amendment in 1999 became necessary as many of the institutions earning profits claimed exemption under earlier law² in the guise of carrying on an educational activity. The assessing authority took the view that whenever a profit/surplus is made by an educational institution, it was treated as an institution one of making profit and ceases to exist for educational purposes. This test applied by the Assessing Authority is not a test laid down by the Supreme Court. In support of such a view taken by the Assessing authority, the decision of Uttarkand HC was relied upon which laid down thus:-

¹ Inserted by Art 2 of 1998 with effect from 1-4-1999.

² See Section 10(22) of Pre-amended Income-Tax Act.

“If an educational institution in fact makes a large profit, even though it may plough back such profits into the purchase of assets for education, yet such institution cannot be said to be existing solely for educational purposes it would then become an institution which would really be for profit”.

Charitable purpose has been defined by the Income-tax Act as one ‘which includes the relief to the poor, education, medical relief and the advancement of any other object of general public utility’.

3. In a case before the Supreme Court,³ the following principles were laid down:-

- i) Every trust or institution must have a purpose for which it is established;
- ii) Every purpose must for its accomplishment involve carrying on an activity;
- iii) Not merely an activity results in profit but it must be carried on with the object of earning profit for the denial of exemption;
- iv) If the predominant object of an activity is profit-making i.e., carried on not for the object for which it exists (charitable purpose) then the exemption could be denied;
- v) If not pervaded by profit motive but carried on primarily to serve a charitable purpose, then it will not be an activity – for profit;
- vi) If the activity is carried on with the predominant object of earning profit, it would be an activity for profit, though it may be carried on in advancement of the charitable purpose of the trust or institution. In other words, it must be for a charitable purpose to get the exemption and the predominant object of such activity must be to serve the charitable purpose;
- vii) The charitable purpose should not be sub-merged by the profit-making motive and profit-making motive should not masquerade under the guise of the charitable purpose.

In a number of decisions of the court, tests have been described to Judge the real nature of the activity to allow or reject the claim under Income-tax Act. They must be stated thus:-

³ CIT Vs. Surat Art Silk Cloth Manufacturers Association, AIR 1980 SC P.387.

4. For getting the advantage of exemption

- i) The purpose of the trust “must be essentially charitable in nature”⁴. It must not be a cover to make profit-making motive or object;
- ii) An activity which is charitable in nature, but carried on commercial basis with the object of profit-making was considered as a charitable purpose.⁵ This aspect of the law was statutorily got rid of by Sec 2 clause (15) of IT Act which provides that the activity ‘should not be carried on of any activity for profit’. This change in the Income-tax law prevented the advantage being taken by institutes run on commercial basis claiming to serve a public purpose, when pre-dominant motive of the institution was to earn profit.
- iii) In sole Trustee, Loka Shikshana Trust case,⁶ the Supreme Court held ‘that if the profits must necessarily feed a charitable purpose under the terms of the trust, the mere fact that the activities of the trust yield profit will not alter the charitable character of the trust;
In other words, the genuineness of the purpose tested by the obligation created to spend the money exclusively or essentially on charity would be real test
- iv) Profit-making should not be the driving force behind the activity and the degree or extent of profit-making may be of such a nature as to reasonably lead to the inference that the real object of the activity is profit-making and not serving the charitable purpose;
- v) As observed by Justice Krishna Iyer, in the case of Indian Chamber of Commerce, ”a pragmatic condition, written or unwritten, proved by a prescription of profits or by long years of invariable practice or spelt from some strong surrounding circumstances would be indication of anti-profit motivation and qualifies for charitable purpose” to claim the advantage of exemption;
- vi) Profit-making motive or object cannot be determined by mere fact that the charitable object results in yielding profit.

If the constitution of the institution makes no express provision, the real nature of institution can be determined by the following:-

⁴ Dharma Deepti Vs. C.I.T. AIR 1978 SC 1417.

⁵ See Privy Council’s decision in Tribunal’s case, AIR 1939 PC 208.

⁶ AIR 1976 SC P 348.

- a) the nature of the charitable purpose;
- b) the manner in which the activity for advancing the charitable purpose being carried on; and
- c) the surrounding circumstances

if it indicates that the activity is not propelled by dominant profit motive i.e., all the facts and circumstances of the case is to be considered to find out the dominant object of the activity whether profit-making or charitable purpose.

vii) In Aditanar Educational Institution's case,⁷ the Supreme Court laid down thus:-

- i) The availability of exemption should be evaluated each year to find out whether the institution existed during the relevant year solely for educational purposes and not for the purposes of profit;
- ii) After meeting the expenditure, if any surplus results incidentally from the activity lawfully carried on by the educational institution, it will not cease to be one existing solely for the educational purposes, since the object is not to make profit;

viii) In American Hotel & Lodging Association Educational Institution's case,⁸ the following tests are laid down to be applied:-

- a) Predominant object of the activity is to be seen for finding out whether it exists solely for the purposes of education and not to earn profits;
- b) The educational purpose will not lose its character merely because some profit arises;
- c) The educational institution cannot be carried on in such a way that the expenditure exactly balances the income and there is no resultant profit. This is not practical to be achieved but results in unsound principles of management;
- d) It is the duty of the prescribed authority to ascertain whether the balance of income is applied wholly and exclusively to the object for which the institution is established and the determination of

⁷ Aditanar Educational Institution Vs. Addl. Commissioner of Income-tax AIR 1997 SC P.1436.

⁸ (2008) AIR SCW P.4996.

the object of the institution is to earn profit or advance the causes of education.

ix) In Oxford University Press case,⁹ the following principles were laid down:-

- a) It is not necessary to look at the profit of each year;
- b) The nature of the activity must be considered;
- c) If the activity has no co-relation with education, exemption has to be denied.

5. The new provision i.e., Section 10(23-C)vi¹⁰, provides for the following:-

- i) The applicant, who seeks approval, has not only to show that it is an existing solely for educational purposes but make the application in standardised form as mentioned in the section;
- ii) It provides for the application of income to the object for which the institution is established;
- iii) It also provides for circumstances under which the prescribed authority is empowered to withdraw the approval earlier granted¹¹ after complying with the procedure mentioned in the Act”.

6. The Income-tax Appellate Tribunal has given the reasons for granting exemption.¹² They can be stated thus:-

- i) If the amount of investment and fixed deposits such as building, furniture etc., were kept in view, there is no surplus left;
- ii) Undoubtedly engaged in educational activities – Imparting education, maintaining teaching and non-teaching staff, pay for salaries and other incidental expenses;
- iii) Charging of tuition fee from students incidental to prominent objective of the trust i.e., imparting education;
- iv) Paying rent to the educational building or acquiring its own property, computer, library books, sports equipment etc., for the benefit of students;
- v) Members of the institution not utilising any part of surplus for their own benefit;

⁹ AIR 2001 SC P.886.

¹⁰ Inserted by Finance Act 2 of 1998.

¹¹ See for details Sec 10 (23-C)vi of the IT Act.

¹² M/s. Queen’s Educational Society Vs. Commissioner of Income-tax, AIR 2015 SC P.3253. Refer to Para 12 of the Judgment.

- vi) Not getting any financial assistance from Govt., or other bodies, but to raise their own funds.

The reasons mentioned aforesaid makes the educational institution to expect some resultant and incidental profits/surplus for the better management of the institution and to give high quality education to students.

- 7. When the surplus is ploughed back for educational purposes, the educational institution exists solely for educational purposes and not for profit.¹³ However, the surplus should result incidentally and not intentionally aimed at. This can be shown that the fees charged are reduced and to ensure that profits do not accrue year after year. Apart from reducing the fees, reduce the prices of its services to students and others in the institution. It may also contribute to CSR under the Companies Act to spend money for the activities enumerated in CSR. In order to ensure that the exemption is not withdrawn, the parameters of earning profit beyond 15% and its investment wholly for educational purposes may be statutorily stipulated. The capital expenditure wholly and exclusively to the objectives of education must be entitled to qualify for exemption and would not constitute part of total income for the purposes of Income-tax Act.

v) **Conclusion & Recommendations**

- 8. In conclusion, the following may be stated¹⁴:-
 - i) The pre-dominant nature of the activity must be educational;
 - ii) Any profit / surplus should be incidental and not intentionally aimed;
 - iii) Any profit / surplus should be ploughed back for educational purposes like improving teaching according to latest technology to improve the quality of education, better facilities and infra-structure;
 - iv) Since the knowledge in contemporary times is technology driven, educational institutions should respond to changes.No provision of Income-tax law requires that educational institutions should maintain 'status quo' as it was at the time of establishment;

¹³ See Surat Silk Cloth, AIR 1980 SC P.387, Aditanar AIR1987 SCP 1436.

¹⁴ Section 10(23 c) (iii ad), Rule 26A, Section 2(15), Section 2 Clause (15); Sec 10 (23-C)vi of Income-tax Act keeping in view of the apex court ratio in several leading cases so that excellence in draftsmanship may contribute to quality justice in Income-tax cases.

- v) Activities of the institution should be looked into vary carefully;
- vi) Some part of the surplus can be spent for CSR activities as mentioned in the Companies Act. For this Income-tax Act must make suitable provision in the Act like in the case of Swachh Bharath which is already provided;
- vii) The various provisions in the Income-tax law relating to exemption for educational institution are unduly complex, lengthy and technical, there is need to simply all these provisions relating thereto be simplified in easy language and put in one para only exceeding not more than (15) lines so that the application, and enforcement including compliance may become easy and make Income-tax friendly to assesses and
- viii) There should be a specific provision in the Constitution of the institution that the activity shall be carried on the basis of 'no profit, no loss' and the profits shall be prescribed.