

## “Charitable Objects” under Income Tax Act”



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### Introduction

In general sense the word 'Charity' connotes altruism in thought and action. It involves an act of benefiting others rather than oneself. Under Income tax act, the income of a charitable organisation is eligible for exemption from tax under section 11 or under section 10(23C) of the Act. The conditions under which the income of the trust is exempt under the provisions of the Act are clearly laid down under Section 11 as well as in Section 12 of the Act. Section 11 of the Act specifically points out the circumstances under which the income of the trust is not to be included in the total income of the previous year of the trust and Section 12 prescribes the procedure for registration of charitable trust. However, many times entities who were engaged in commercial activities are also claiming exemption on the ground of 'Advancement of objects of general public utility" i.e. the last limb of the definition of "charitable purpose" where an entity uses this status of charitable institution as a mask or a device to hide the true purpose and their object is nothing other than trade, commerce or business or the rendering of any service in relation to trade, commerce or business.

### Meaning of Charitable purpose as Per Income Tax Act

The expression "charitable purpose" has been defined under Section 2(15) of the Act, the same is as follows "charitable purpose" includes relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility.

**Proviso 1 to section 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;

However the term "charitable purpose" remains an inclusive one and is not an exhaustive or exclusive one. In other words, the purposes similar to those mentioned in the aforesaid definition could also constitute 'charitable purpose' under the Act. Many times Courts have held that the expression 'charitable purpose' is sufficiently wide in scope to include a variety of activities. For instance, promotion of sports and games is a charitable purpose, as is promotion of trade and commerce, even when the beneficiaries are confined only to a particular line of trade or commodity. However, at the same time, the fact that remote and indirect benefits are derived by the members of the public will not be sufficient to make the purpose a "charitable purpose" under the Act. The intention of the law maker is clear that as long as the object of general public utility is not merely a mask to hide true purpose, income generated from the activities of the trust will be exempt under section 11 of the act.

### Applicability of proviso to Section 2(15)

The proviso 1 to section 2(15) will not apply in respect of the first three limbs of section 2(15), i.e., relief of the poor, education or medical relief. Consequently, where the purpose of a trust or institution is relief of the poor, education or medical relief, it will constitute 'charitable purpose' even if it incidentally involves the carrying on of commercial activities subject to the conditions mentioned below:

- (i) The business should be incidental to the attainment of the objectives of the entity, and
- (ii) Separate books of account should be maintained in respect of such business.

Thus, assessee, who claim that their object is charitable purpose within the last limb of Section 2(15) i.e advancement of any other object of general public utility, would be well advised to eschew any activity which is in the nature of trade, commerce or

business or the rendering of any service in relation to any trade, commerce or business. Also it is evident from the reading of Circular No.11 of 2008 dated 19.12.2008, the object of the insertion of first proviso to Section 2(15) of the Act was only to curtail institution, which under the garb of 'general public utility', carry on business or commercial activity only to escape the liability under the Act thereby gain unmerited exemption under Section 11 of the Act. Whether such an entity is carrying on an activity in the nature of trade, commerce or business is a question of fact which will be decided based on the nature, scope, extent and frequency of the activity. The Delhi High Court in the case of Institute of Chartered Accountants of India v. Director General of Income- observed that while disposing of a writ petition, that holding interviews for fees for the purpose of campus placements of its students does not amount to carrying on a business so as to deny exemption u/s 11 of the Act. It further observed that if the object or purpose of an institution is charitable, the fact that the institution collects certain charges does not alter the character of the institution. It further observed that "the purport of the first proviso to section 2(15) of the Act is not to exclude the entities which are essentially for charitable purpose, but are conducting some activities for a consideration or a fee. The object of introducing the first proviso is to exclude the organizations which are carrying on regular business from the scope of 'charitable purpose'

#### **Analysis of "Relief to poor" and Education in the Light of Judgements**

**a) Relief to the poor :** Relief to the poor encompasses a wide range of objects for the welfare of the economically and socially disadvantaged or needy. It will, therefore, include within its ambit purposes such as relief to destitute, orphans or the handicapped, disadvantaged women or children, small and marginal farmers, indigent artisans or senior citizens in need of aid. Entities who have these objects will continue to be eligible for exemption even if they incidentally carry on a commercial activity.

**b) Education:** It is a settled position that "education" is a term with a very wide meaning, going beyond traditional classroom teaching and taking within its ambit training in sports. The Hon'ble Supreme Court in Sole Trustee, Loka Shikshana Trust v. CIT held that the meaning of "education" is not to be narrowly construed. Advancement of knowledge brings within its fold suitable methods of its dissemination and though the primary method of sitting in a classroom may remain ideal for most of the initial education, it may become necessary to have a different outlook for further education. It is not necessary to nail down the concept of education to a particular formula or to flow it only through a defined channel. Its progress lies in the acceptance of new ideas and development of appropriate means to reach them

to the recipients." In the case of Delhi Music Society vs. DGIT [2013], it was held that assessee society object clause "says that the objects of the school are to teach western, classical music, to promote musical knowledge and the appreciation among the students as well as among the interested public by means of workshops, lectures/demonstrations, recitals etc., to acquire and maintain instruments for teaching purposes, to create and update a world class library of music literature both audio and video to add more class rooms and other required facilities for the purpose of musical education and to construct and maintain concert hall/auditorium for the school" was held to be an educational institute under Section 10(23C)(vi) of the Act.

#### **Scope of the term "advancement of any other object of general public utility"**

The words 'public utility' or 'general public utility' are not capable of a precise meaning. In other words, any activity for the benefit of the public or a section of the public, would be charitable purpose. In the case of Hiralal Bhagwati v. CIT, the Gujarat High Court held that to serve as a charitable purpose, it is not necessary that the object must be to serve the whole of mankind or all persons living in a country or province; it is required to be noted that if a section of the public alone are given the benefit, it cannot be said that it is not a trust for charitable purpose in the interest of the public; it is not necessary that the public at large must get the benefit; the criteria here is the objects of general public utility. It further held that in order to be charitable, the purpose must be directed to the benefit of the community or a section of the community; the expression "object of general public utility", however, is not restricted to the objects beneficial to the whole of mankind; an object beneficial to a section of the public is an object of general public utility; the section of the community sought to be benefited must undoubtedly be sufficiently defined and identifiable by some common quality of a public or impersonal nature. The Apex Court in the case of Ahmedabad Rana Caste Association vs. CIT, pointed out that the law recognises no purpose as charitable unless it is for a public charity. However, the section of the community sought to be benefited must undoubtedly be sufficiently defined and identifiable. The Supreme Court in the case of Andhra Chamber of Commerce held that personal welfare of specified individuals would be incidental or consequential to the main purpose of general public utility, but a converse of this proposition is not always true. Therefore, when an object seeks to promote or protect the interests of a particular trade or industry, that object becomes an object of public utility, but not so, if it seeks to promote the interests of those who conduct the said trade or industry.

The Delhi High Court, in the case of M/s. GST India vs. DIT, Delhi,

reported in 360 ITR 138, held that "there are four main factors that need to be taken into consideration before classifying the activity of the assessee as "charitable" under the residuary category, i.e.," advancement of any other object of general public utility" under section 2(15) of the Act. The four factors are

- (i) The activity should be for advancement of general public utility;
- (ii) The activity should not involve any activity in the nature of trade, commerce and business;
- (iii) The activity should not involve rendering any service in relation to any trade, commerce, or business; and
- (iv) the activities in clauses (ii) and (iii) should not be for fee, cess or other consideration and if for fee, cess or consideration the aggregate value of the receipts from the activities under (ii) and (iii) should not exceed the amount specified in the second proviso i.e. 20% of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year;

In *Commissioner of Inland Revenue v. City of Glasgow Police Athletic Association* [1953] 34 TC 76 (HL) Lord Cohen has summarised the legal position in such cases as under at page 105 of the report :

"(1) If the main purpose of the body of persons is charitable and the only elements in its constitution and operations which are non-charitable are merely incidental to that main purpose, that body of persons is a charity notwithstanding the presence of those elements - *Royal College of Surgeons of England v. National Provincial Bank* [1952] AC 631 (HL).

(2) If, however, a non-charitable object is itself one of the purposes of the body of persons and is not merely incidental to the charitable purposes, the body of persons is not a body of persons formed for charitable purposes only, within the meaning of the Income Tax Act - *Oxford Group v. Inland Revenue Commissioner* [1949] 2 All ER 537; 31 TC 221 (CA).

(3) If a substantial part of the objects of the body of person is to benefit its own members, the body of persons is not established for charitable purposes only - *Inland Revenue Commissioner v. Yorkshire Agricultural Society* [1928] 1 KB 611 (CA)."

#### **Cancellation of Trust is not valid for mere carrying of commercial activities**

As per Section 12AA(3) of the Income Tax Act "Where a trust or an institution has been granted registration under clause (b) of sub-section (1) or has obtained registration at any time under section 12A as it stood before its amendment by the Finance (No.2) Act, 1996 (33 of 1996) and subsequently the Commissioner is satisfied that the activities of such trust or institution are not

genuine or are not being carried out in accordance with the objects of the trust or institution, as the case may be, he shall pass an order in writing cancelling the registration of such trust or institution." Thus it is evident that the question of rejection of registration under Section 12AA(3) of the Act would arise only in those cases where an entity uses this status of charitable institution with a charitable object of general public utility as a mask or a device to hide the true purpose and that object is nothing other than trade, commerce or business or the rendering of any service in relation to trade, commerce or business.

Once it is established that the objects of the trust are of "general public utility" and that no activities deviating from the objects have been carried out, mere generation of surplus cannot turn it into an activity in the nature of trade, commerce or business. Since the terms trade, commerce or business is not defined under the scheme of the Act, general or dictionary meaning has to be resorted to. In order to determine whether an activity is in the nature of trade, commerce or business or charitable, the determining factor is profit motive.

It is well established that the 'earning of surplus' itself would not mean that the appellant existed for profit. 'Profits' means that surplus over which the owners of the entity have a right to withdraw for any purpose including the personal purpose. Charitable activities require operational/running expenses as well as capital expenses to be able to sustain and continue in the long run. There is no statutory mandate that a charitable institution falling under the last clause should be wholly, substantially or in part must be funded by voluntary contributions. A practical and pragmatic view is required to examine the data, which should be analysed objectively and a narrow and coloured view will be counter-productive and contrary to the language of section 2(15). The second proviso applies when business is conducted and the quantum of receipts exceeds the twenty per cent of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year. The proviso does not seek to disqualify a charitable organization covered by the last limb, when a token fee is collected from the beneficiaries in the course of activity which is not a business but clearly charity for which it is established and it undertakes." The supreme Court in the case of *Surat Art Silk* held that if the predominant object of the trust is of charitable nature and with no-profit motive, the said activities cannot be treated as trade, commerce or business merely because some surplus has remained left over the expenditure to carry out such activities. Thus, the proviso to section 2(15) of the act should not be generalized to each and every facts of the case where there is a surplus over the expenditure in respect of the

activities or objects carried out by the Trust which are in any case of the charitable purpose, the cardinal principle is the predominant object of the Trust.

#### **Conclusion**

Whether the activities of a trust are genuine or not is a question of fact. The intention of legislature is not aimed at excluding the genuine charitable trusts of general public utility but is aimed at excluding activities in the nature of trade, commerce or business

which are masked as 'charitable purpose'. Enrichment of oneself or self-gain should be missing and the predominant purpose of the activity should be to serve and benefit others. Merely because an activity is performed in an organized manner, that alone, will not make such activities as business/commercial activity. In carrying out an activity, one may earn profit or one may incur loss. But for making it as a business activity, the presence of the profit motive is sine qua non.

The views expressed herein are personal views of the author and do not necessarily represent the views of the NIRC

## FEEDBACK

We wish to inform you that the Northern India Regional Council (NIRC) of The Institute of Chartered Accountants of India (ICAI) at its meeting held on 27th February, 2020 elected its Office-Bearers for the year 2020-2021

The NIRC at its aforesaid meeting in accordance with Rule 13(b) of the Chartered Accountants Students' Association Rules, nominated the NICASA Chairman & Members on the Managing Committee of the NICASA for the year 2020-2021

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