

“SOLELY” MEANS ‘ONLY’ - SUPREME COURT ON SCOPE OF EXEMPTION U/S 10(23C)

The Supreme Court in the recent ruling rendered in the batch of matters,¹ was called upon to consider issues relating to registration of an institution [being in the nature of a fund, trust, university or any other educational institutions] set-up for educational purposes and not for purposes of profit, for grant of exemption under section 10(23C) of the Income-tax Act, 1961 (‘the Act’).

The genesis of the controversy lay in the meaning and purport of the phrase “*existing solely for educational purposes and not for purposes of profit*” as appearing under sub-clauses (iiiab), (iiid), (iv) and (vi) of clause (23C) of section 10 of the Act as well as the various provisos appended thereto. In the course of the debate, the Court was, inter-alia, called upon to consider the correctness and tenability of the earlier rulings of the Apex Court rendered in the cases of *American Hotel*² and *Queen’s Education Society*,³ which had canvassed an expanded approach to the meaning of the word “solely” as finding reference in the said provision.

Additionally, the Court was also seized with the questions relating to, *firstly*, the scope of inquiry which the Prescribed Authority (‘PA’) or the Commissioner could undertake while considering the grant of approval/ registration for exemption under section 10(23C) of the Act, and, *secondly*, the requirement, if any, for the concerned assessee to comply with other laws, including local/ state laws, to the extent that the same has a bearing on the grant of such approval for exemption under the Act.

Issues framed by the Court

While dealing with the controversy at hand, the Court framed three substantial issues:

- i. *Firstly*, the Court was to adjudicate upon the correct meaning and purport of the term “solely” as appearing under various sub-clauses of section 10(23C), which exempts income of “*any university or other educational institution existing solely for educational purposes and not for purposes of profit*”;
- ii. *Secondly*, the Court was to delineate the scope and extent of inquiry, which could be undertaken by the PA or the Commissioner, while considering an application for grant of approval/ registration for exemption under section 10(23C);
- iii. *Thirdly*, whether compliance with other/ local laws was also relevant consideration, which could weigh in the hands of the PA or the Commissioner while considering the application for grant of registration to a charitable educational institution under section 10(23C) of the Act.

Earlier legal position delineated by the Court

With respect to the *first question*, the Court took note of the legal position outlined in the previous judgments rendered, inter alia, in the cases of *American Hotel* and *Queen’s Education Society* – the Apex Court therein had affirmed and applied the test of “*predominant object*” as outlined in the earlier 5-Judge bench decision in the case of *Surat Art*.⁴ The said judgment in *Surat Art*, though

¹ *M/s New Noble Educational Society vs. The Chief Commissioner of Income Tax* [C.A. No.3795/2014; Judgment dated 19.10.2022] (SC)

² *American Hotel and Lodging Association Educational Institute vs. Central Board of Direct Taxes* [2008] 301 ITR 86 (SC)

³ *Queen’s Education Society vs. Commissioner of Income Tax* (2015) 8 SCC 47

⁴ *Additional Commissioner of Income Tax vs. Surat Art Silk Cloth Manufacturers’ Association* (1980) 2 SCC 31

rendered in the context of section 2(15), was applied for determining eligibility for exemption under section 10(23C) of the Act.

In *Surat Art*, a 5-Judge Bench, while considering the expression “*not involving the carrying on of any activity for profit*” then used in the definition of ‘charitable purpose’ in section 2(15) laid down the test that if the primary or dominant purpose/ object of a trust/ institution is charitable, then, merely because some profit arises would not per se result in such trust or institution ceasing to be charitable in nature.

Applying the aforesaid test in the context of determination of eligibility of exemption under section 10(23C), the Supreme Court in *American Hotel* and *Queen’s Education Society* held that *an institution, being primarily and predominantly engaged in the object/ purpose of furthering education, would not otherwise be disentitled to claim the benefit of exemption under section 10(23C) of the Act merely because a surplus arises.*

As regards the **second question**, i.e., the scope and extent of inquiry which could be undertaken by the PA or the Commissioner while considering an assessee’s application for grant of exemption under section 10(23C) of the Act, the Apex Court in *American Hotel* held that at the stage of grant of approval the PA is only required to examine ‘*the nature, activities and genuineness of the Institution*’. The Court further held that conditions stipulated under the provisos to section 10(23C) of the Act would be in the nature of compliance conditions, which were to be complied with by the assessee to avail exemption in respect of its income, year to year, but not the basis upon fulfilment of which such approval was to be granted.

Decision of the Supreme Court

On the first issue, the Court has:

- drawn a distinction between the narrower meaning of education as encapsulated under Articles 21A, 29-30 and 45-46 of the Constitution and the relatively expansive meaning of the term under the Act - in this respect, the Court cited the observations made in the earlier ruling of *Loka Shikshana Trust*⁵, which holds that education “*connotes the whole course of scholastic instruction which a person has received*”, i.e., “*the process of training and developing the knowledge, skill, mind and character of students by former schooling*”. Importantly, the aforesaid purport of the term “education” referenced under the Act and affirmed by the ruling in *Loka Shikshana Trust* has not been disturbed or diluted by the Apex Court;
- disapproved application of the ‘predominant object test’ outlined in the judgment of *Surat Art*, rendered in the context of section 2(15), to the determination of grant of exemption under section 10(23C) to institutions engaged in educational activity. The Court has reasoned that the former case “*was decided in the context of a society that did not claim to impart education*” and wherein, “*the Court had no occasion to deal with the term ‘educational institution existing solely for educational purposes and not for purposes of profit’*” - the Court has thus concluded that the application of the test of predominant object, as outlined by the ruling in *Surat Art* rendered in the context of section 2(15), has no application in the context of grant of exemption under section 10(23C) of the Act;
- disagreed with the conclusion reached in the earlier judgments of *American Hotel* and *Queen’s Education Society* on the ground that the said rulings did not explore the true meaning of the expression “solely”. The Court thus concluded that in order to fall within the beneficial scheme of section 10(23C) “*a trust, university or other institution imparting*

⁵ *Sole Trustee, Loka Shikshana Trust vs. Commissioner of Income Tax* [1975] 101 ITR 234 (SC)

education, as the case may be, should necessarily have all its objects aimed at imparting or facilitating education”;

- also pointed out that the exception to the strict conditions outlined under section 10(23C) [i.e., existence of an “*educational institution solely for educational purposes and not for the purposes of profit*”], cannot be diluted by looking into the (7th) proviso thereto, which merely carves out a limited exception in respect of generation of business income from activities ancillary to education - in other words, the beneficial purport of the said proviso cannot be gone into for the purposes of testing the fulfilment of eligibility for exemption under the primary provision of section 10(23C) of the Act.

With respect to the partial exception or benefit outlined under the 7th proviso, the Court concluded that the (incidental) business contemplated therein “*has to be read as the education or educational activity - and **nothing other than that***”; meaning thereby, that only such activities which are incidental and ancillary to education [such as provision of text books, school bus facilities, summer camp for special courses, hostel facilities for registered students, etc.] would partake the character of ancillary business activities covered within the scope of the 7th proviso to section 10(23C). In this context, the Court has drawn a parallel between the scope of the 7th proviso to section 10(23C) and section 11(4A) of the Act.

On the second issue, the Court has once again departed from the limitation sounded off in the judgment of *American Hotel*, to conclude that while examining or considering the assessee’s application for grant of exemption under section 10(23C) of the Act, the scope of inquiry at the hands of the PA or the Commissioner is not limited/ circumscribed to examining the object and/or the purpose of the concerned institution, but could entail aspects outlined under the various provisos to the said provision. In other words, the PA or the Commissioner, while considering the application for exemption under section 10(23C) of the Act, is empowered to call for documents and evidence to satisfy itself, not only of the object and purpose of the institution, but also the genuineness and operations thereof. At the same time, the Court also cautioned that such *inquiry should confine itself to the nature of income and focus should lie “on the activity and not the proportion of income”*.

On the third issue, the Court mandated that compliance with other laws including local and state laws which may apply to a charitable institution or society is required to be undertaken and such compliance/ fulfilment may also be a legitimate consideration weighing with the PA or Commissioner, while considering the application for grant of approval under section 10(23C); in this respect, the Court has, once again, drawn a parallel between underlying objective of the 7th proviso to section 10(23C) and section 11(4A) of the Act.

VA COMMENTS:

- The Apex Court has upset the earlier prevailing legal position emanating from the judgments of *American Hotel* and *Queens Education Society* and discarded the application of the ‘predominant object test’ laid down in *Surat Art*, to the consideration of exemption under section 10(23C) of the Act. While doing so, the Apex Court has laid substantial emphasis on the word ‘**solely**’ followed by the expression ‘for educational purposes’ in section 10(23C) to mean only and to the exclusion of all others.

Pertinently, the earlier judgments of *American Hotel* and *Queens Education Society*, followed the decision of the 5-Judge Bench in *Surat Art* wherein the Court considered the expression “not involving the carrying on of any activity **for profit**” and held that the proposition “**for**” when used with the active participle of a verb, means “**for the purpose of**” and connotes the end with reference to which something is done. The Court thus, laid down the ‘predominant

object test’ to hold that where the predominant object of the activity is to subserve charitable purpose and not to earn profit, then, the activity is not hit by the expression ‘not involving the carrying on of any activity **for profit**’

It may be noted that section 10(23C) also similarly uses the expression “*any university or other educational institution existing solely for educational purposes and **not for purposes of profit***”. The highlighted expression was considered in *Surat Art* while laying down the predominant object test and that was precisely the reason for the predominant object test being applied in *American Hotel* and *Queens Education Society*.

- ii. The Apex Court has greatly expanded the scope of inquiry that could be undertaken by the PA and the Commissioner while considering an assessee’s application for grant of approval under section 10(23C), inasmuch as, apart from the objects and purpose of the institution, the authorities are now empowered to look at the modus operandi of such institutions, the manner in which educational activities are rendered, as well as, compliance with other laws including local or state laws - consequently, the scope of inquiry and latitude available to the Revenue has been greatly expanded;
- iii. While restricting the availability of benefit of exemption under section 10(23C), the Court has also (indirectly) limited the scope of incidental activities earlier covered under the 7th proviso to section 10(23C) - as a result, only incidental activities, i.e., the examples cited by the Court, such as provisioning of books, bus facilities, summer camps and hostel facilities, alone would be covered within the permissible ambit of the 7th proviso to section 10(23C). Accordingly, the mandatory conditions of 7th proviso, being maintenance of separate books of account, etc., would have to be complied with qua such activities and income derived therefrom.
- iv. The Court has specifically held that the aforesaid reasoning shall equally apply to section 11(4A) of the Act. Consequently, charitable trusts/ institutions existing for purposes of imparting education and claiming exemption under sections 11/ 12 of the Act, too, shall be required to comply with the conditions of maintenance of separate books for such activities.
- v. Importantly, considering the fact that the judgment has departed from the earlier prevailing legal position, also overruling the judgments of *American Hotel* and *Queens Education Society*, the Court has declared that ***the law laid down therein shall apply prospectively***, thereby giving “*time to institutions likely to be effected to make appropriate changes and adjustments*” - considering the law now laid down by the Apex Court, educational institutions claiming the benefit of exemption under section 10(23C) of the Act, would be required to carry out sweeping changes, not only to their incorporation documents, including the object’s clause of the memorandum of association, but also, the allied and incidental activities carried out as a means for facilitating education.

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