

EY Tax Alert

Supreme Court interprets the scope of "general public utility" for claiming tax exemption for charitable institutions

Executive summary

Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

This Tax Alert summarizes a three-judge bench Supreme Court (SC) ruling, dated 19 October 2022, in a batch of appeals with Ahmedabad Urban Development Authority¹ as the lead case (Taxpayers). The issues adjudicated by the SC are related to determining the scope of the phrase "general public utility" (GPU) in the definition of "charitable purposes" and rejection of claim for tax exemption as charitable institutions under the Income Tax Laws (ITL), primarily on the grounds that the institutions were carrying on trade, commerce or business for consideration, which does not qualify as GPU under the provisions of the ITL as amended by Finance Act (FA), 2008 read with subsequent amendments.

Before the SC, while most of the entities and activities involved in the appeal qualified as GPUs within the meaning of the term "charitable purposes", debate surrounded the meaning of "fee cess or other consideration" and its impact on construing whether the activity answers to the description of "trade, commerce or business".

The SC held that where "fee, cess or other consideration" is statutorily fixed or where it represents recoupment of cost or cost with nominal mark up, the activity may not be construed as "trade, commerce or business" and will be excluded from the mischief of commercial activity under the amended provision. If, however, "fee, cess or other consideration" charged is substantially higher over cost, it is tainted with "trade, commerce or business" and will qualify for tax exemption only if receipts are within the quantitative limit prescribed by the amended provision.

¹ [TS-814-SC-2022]

By applying the above principles and examining the overall facts and purpose of the Taxpayers from varied fields/industries (e.g., statutory bodies, trade promotion bodies, private trusts, sports associations etc.) in the appeal, the SC adjudicated on the claim of tax exemption in each case.

Background

- ▶ The ITL provides tax exemption to trusts or bodies engaged in “charitable purposes”, subject to fulfilment of conditions. Charitable purposes include relief to the poor, education, yoga, medical relief etc., and contain a residuary clause of “advancement of any other object of GPU”.
- ▶ The expression GPU has been interpreted widely by the courts in the past to include activities of authorities, corporations or bodies established by statute such as Gujarat Industrial Development Corporation (GIDC), statutory regulatory bodies/authorities such as Institute of Chartered Accountants of India (ICAI), trade promotion bodies or associations or organizations such as Apparel Export Promotion Council (AEPC) etc. These bodies or institutions were founded to provide activities of GPU of charitable nature.
- ▶ However, the scope of residuary clause of GPU in the recent past has experienced various amendments under the ITL, starting from FA 2008. As it presently stands and is considered by the SC, GPU will not qualify as charitable purposes if it is engaged in “carrying on of any activity in the nature of trade, commerce or business for a cess, fee or consideration” (referred to as “non-qualifying activity”). As an exception to such disqualification, tax exemption is allowed where such activity of the nature of trade, commerce or business is undertaken in the course of advancement of the object of GPU and it does not breach a quantitative threshold² as prescribed in the ITL.
- ▶ Prior to the 2008 amendment, the erstwhile provisions, by and large, did not prohibit the carrying on of the business by the charity. The legislative history suggests that, earlier, the only condition was that the business should be carried on in the course of actual carrying out of a primary purpose of the institution and if income from such business is applied for charitable purposes, such income earned exemption under the ITL. Later, the requirement changed. As of now, business activity was permissible if the business was incidental to the attainment of the objectives of the trust and separate books of accounts were maintained.
- ▶ Under the pre-amended era, Indian jurisprudence contained a plethora of judgments, including from the SC, on interpretation of GPU over the years and application of its conditions to various kinds of

trusts and bodies. Specifically, the following may be noted:

- ▶ Five-judge bench decision in the case of ACIT v. Surat Art Silk Cloth Manufacturers’ Association³ which was a trade association, where the SC had articulated the determinative test for defining whether a trust was a GPU charity if its predominant object was to carry out a charitable purpose and that if that were the case, the fact that it earned profit would not per se deprive it of tax exemption. But, where an activity is carried on with the predominant object of earning profit, then the same may be prohibited from tax exemption. It further clarified that the prohibition of trade or commerce is applied to the object and not the advancement or attainment of the said object.
- ▶ In another landmark case of ACIT v. Thanthi Trust⁴, the two-judge bench of the SC held that if the income generated from a newspaper business is applied to the object of imparting education (feeding the charitable purpose of education), such business, being “incidental” to the charitable object of the trust (viz., imparting education), the exemption may be allowed.

Issue before the SC

- ▶ The Taxpayers, in the batch of appeals, are from different fields or industries and include authorities, corporations, or bodies established by statute such as GIDC, Maharashtra Industrial Development Corporation (MIDC), New Okhla Industrial Development Authority (NOIDA), statutory regulatory bodies/authorities such as ICAI, trade promotion bodies, councils, associations or organisations such as AEPC, non-statutory bodies such as Education and Research Network (ERNET), National Internet Exchange of India (NIXI), GS1 India, sports associations like Board of Control for Cricket in India (BCCI) and private trusts.
- ▶ Furthermore, the SC was concerned with the scope of the provision dealing with GPU post its amendment by FA 2008 and subsequent amendments.
- ▶ In the appeals of different taxpayers, various High courts (HCs) have interpreted the amended provision and held that carrying on trade commerce or business in itself is not a disqualification for GPU category charitable institutions and allowed the taxpayers’ claim for exemption.

² The quantum of receipts from activities (i.e., any trade, commerce or business for a cess or fee or any other consideration) should exceed 20% of the total receipts of the charitable institution

³ [(1980) 2 SCC 31]

⁴ [(2001) 2 SCC 707]

- ▶ The tax authorities appealed before the SC, challenging the decisions of various HCs, primarily on the grounds that the institutions were carrying on business activities which do not qualify as GPU under the amended provision.

Taxpayers' contentions before the SC

- ▶ Institutions are established under various laws⁵ that govern their functions. Revenue generation is also as per the parent enactments under which they were created. Furthermore, even if any surpluses are generated, the same are applied for furthering the objects of law and in some cases, kept in a separate fund to be utilized for further development, expansion and development activities by each corporation.
- ▶ Based on various rulings, including the ratio in *Surat Art Silk (supra)* and *Thanthi Trust (supra)*, the main purpose or principal objective or motivation for the activity is not to carry on trade or business. It is to advance the purpose of GPU. If such a purpose is fulfilled, the carrying on of some incidental activity which might result in surplus, would not disentitle the entity from the benefit of tax exemption.
- ▶ Profit motive is a quintessential element and an activity without profit motive will not result in "trade, commerce or business"⁶.
- ▶ Reliance can be placed on certain administrative circulars⁷ and the Finance Minister's speech of 2008, which clearly pointed out that the amendment is to apply to those charitable institutions which were misusing the provisions. Hence, genuine charitable organizations which generate income for their sustenance may not be denied the benefit of tax exemption under the ITL.
- ▶ Amounts earned by statutory organizations based on tariff regulations imposed by the regulatory bodies or statute-based fee can neither be "fee" nor "cess" under the ITL. Fee or consideration collected by such organizations should not be taken in the sense of profiteering, as it is for the advancement of their objectives.
- ▶ If the main activity is not business, the connected, incidental or ancillary activities carried out in furtherance of and to accomplish their main objects would not normally amount to business, unless an independent intention to conduct "business" is established.

Tax authority's contentions before the SC

- ▶ The erstwhile provisions on the GPU test were broader than the current provision as, previously, it did not contain restrictive expressions forbidding trade or business activities by a charity. Thus, in the various rulings referred⁸ to by the Taxpayers, the contextual framework was entirely different and, consequently, it approved carrying on activities akin to business. Likewise, the *Surat Art Silk (supra)* ruling, laying down the test of predominant purpose, is not relevant to the current provision on charitable purpose.
- ▶ Various institutions carry on large commercial activities earning substantial profits. Accordingly, various amendments were carried out in the ITL from time to time to reduce the abuse of such provisions. The intent of the legislature/government was to expressly forbid tax exemption where the entity was involved in carrying on trade or business and to ensure that purely charitable activity-driven institutions could claim exemption.
- ▶ The decisive factor, therefore, is not the status of the entity, but the nature of the activity carried on by it. If the nature of the activity is trade or business with a profit motive, then the same can be taxed even if it is carried on by the state or its instrumentalities.
- ▶ Any incidental activity or proceeds of trade cannot be claimed to be exempt merely because they are ploughed back for charitable objectives.

SC's ruling

On the interpretation of charitable purpose and GPU test under the amended provisions of the ITL

Specific restrictions on GPU on carrying on business activity:

- ▶ The definition of "charitable purpose" has undergone several amendments since 2008. As it stands now in the ITL, a taxpayer advancing GPU cannot engage itself in any trade, commerce or business or provide service in relation thereto for any consideration ("cess, or fee, or any other consideration"). However, such restriction of carrying on of a business activity does not apply to other limbs of charitable purposes such as relief to the poor, education, medical relief etc.

⁵ Gujarat Housing Board Act, 1961, Gujarat Industrial Development Act, 1962, Ahmedabad Urban Development Authority, etc

⁶ State of A.P. v. H. Abdul Bakhi & Bros

⁷ Central Board of Direct Taxes (CBDT) Circular 11/2008 dated 19 December 2008

⁸ The Trustees of the Tribune Press, Lahore v. CIT, Punjab [(1939) 7 ITR 415], CIT v. Andhra Chamber of Commerce [(1965) 1 SCR 565] and CIT v. P. Krishna Warriar [(1964) 8 SCR 36]

- ▶ The amended provisions brought in a paradigm change. In terms of the amended provisions, the GPU test contains the following prohibitions in a four-fold manner:
 - ▶ The bar from engaging in trade, commerce or business. It includes all activities in nature of or resembling the above.
 - ▶ The bar providing any service in relation to trade, commerce or business.
 - ▶ The above two activities are undertaken "for a fee, cess or any other consideration".
 - ▶ The above bar operated even where application of the income from such "prohibited activities" is on the charitable purposes.
- ▶ The amended provisions proceed on the basis that income received as fee, cess or any other consideration derived from "prohibited activities" is necessarily motivated by profits and, hence, disqualify as charitable purposes.
- ▶ The only exception is that in the course of achieving the object of GPU, the taxpayer can carry on trade, commerce or business etc., provided that such activities are connected to the achievement of the objects of GPU and the receipt from such business or commercial activity or service in relation thereto, does not exceed the quantified limit provided in the ITL.

Distinction between business held under the trust⁹ and trust carrying on the business¹⁰:

- ▶ The charity provision of the ITL provides exemption from tax to income derived from property held under the trust wholly for charitable or religious purposes, subject to the condition that income therefrom is applied to such purposes in India. This tax exemption benefit would extend to business held under the trust.
- ▶ If, however, business is not held under the trust, income would qualify for exemption only if such business is incidental to the attainment of objects of the trust and separate books of account are maintained.
- ▶ There is a distinction between business held under the trust and trust carrying on the business. In the former, property in the form of business may be settled by a settlor in the trust, whereas in the latter, the trust carries on business as a source of income for applying it on the object of the trust. In the latter, business is not held under the trust and, hence, it has to meet with the requirement of it being incidental to attainment of the objects of the trust and separate books of account are to be maintained.

Interplay between amended GPU and theory of incidental business

- ▶ The SC addressed the issue of whether there is any conflict between the amended definition of charitable purposes for GPU to the extent it permitted business activity and the ITL provision which extends benefit of exemption to profits from business incidental to attainment of the objects of the trust¹¹ as feeder activity.
- ▶ The SC held that there is no such conflict if both provisions are construed harmoniously. According to the SC, reference to income being profits and gains of "business", with a further reference to it being incidental to the objects of the trust, cannot and does not mean proceeds of activities incidental to main object, incidental objects or income derived from incidental activities. According to the SC, a proper way of reading reference to the term "incidental", is to interpret it in the light of carrying out the activity in the nature of trade, commerce or business (or services in relation thereto) in the context of GPU, which is actually conducted in the course of achieving the GPU object, and therefore, any income or profit or surplus is incidental. Furthermore, the requirement of maintaining separate books of account is also in line with the necessity of demonstrating that quantitative limit prescribed is not breached.

SC rulings in Surat Silk (supra) and Thanthi Trust (supra) are distinguishable

- ▶ The change brought in by the amended provision provides for carrying out the activity for trade or commerce or business which is intrinsically linked to or a part of GPU category charity's objects. Consequently, the test of the charity being driven by a predominant object, as laid down by the SC in the Surat Silks ruling (*supra*), is no longer good law. Furthermore, the "ploughing" back of business income to "feed" charity is an irrelevant factor in the light of the amended provisions.
- ▶ The SC distinguished its ruling in Thanthi Trust (*supra*) on the ground that the said ruling was rendered in the context of "education" being the object of the trust (and not GPU) and the newspaper business that was held under the trust was incidental to the attainment of the objects of the trust. The Thanthi Trust ratio, therefore, cannot be extended to cases where the trust carries on the business which is not held under the trust and whose income is utilized to feed the objects of the trust.

⁹ S. 11(4) of the ITL

¹⁰ S. 11(4A) of the ITL

¹¹ S. 11(4A) of the ITL.

Scope and coverage of trade, commerce or business for a consideration

- ▶ Generally, the charging of any amount towards consideration for such an activity (advancing GPU), which is on cost-basis or nominally above cost, cannot be considered to be "trade, commerce, or business" or any services in relation thereto. It is only when the charges are markedly or significantly above the cost incurred that they would fall within the mischief of "cess, or fee, or any other consideration" towards "trade, commerce or business".
- ▶ The ITL does not envision covering only pure charity performing activities without any consideration. The ITL emphasizes that as long as a GPU charity's object involves activities which also incidentally generate profits, it can be granted exemption, provided the quantitative limit is adhered to.
- ▶ By way of an illustration, the SC cited certain cases not involving activities in the nature of business, such as disseminating Mahatma Gandhi's philosophy through museums and exhibitions and publishing his works for a nominal cost or providing access to low-cost hostels to weaker segments of society at fees capturing the cost plus nominal mark up or renting marriage hall for low amounts or blood bank services at fees to cover cost.

Judgement for authorities, corporations, or bodies established by statute such as statutory housing board, regulatory authorities and corporations¹²:

- ▶ The bodies which carry on statutory functions whose income was hitherto eligible for specific exemption under the ITL (now deleted w.e.f. 1 April 2003) are not precluded from benefit as GPU category charities of the ITL if other conditions are fulfilled.
- ▶ The SC laid down the determinative tests for statutory bodies to qualify as GPU charity e.g., the purpose for which it is set up, does it advance the GPU object, whether carrying on activities in the nature of business, trade or commerce is at cost or nominal mark-up or significantly higher than cost, extent of control exercised by the statute or government on activities of such bodies or prescribe rates etc.
- ▶ Statutory corporations, boards, authorities, commissions etc., (by whatsoever names called) in housing development, town planning, industrial development sectors are involved in the advancement of objects of GPU and are, therefore, entitled to be considered as charities in the GPU categories.

- ▶ The amount charged by a statutory corporation or body set up by the government for achieving what are essentially "public functions/services" may not be considered as trade, commercial or business activities and be excluded from the mischief of commercial activity.
- ▶ The tax authority is required to analyze the facts of the case to determine whether the activities are in the nature of trade, commerce or business and how much mark-up on cost has been charged on a yearly basis. Furthermore, in case where activities are found to be in the nature of business or commercial activities, they may qualify if the threshold given in the ITL definition is met with.

Judgment for statutory regulatory bodies¹³/ authorities¹⁴

- ▶ The SC, after an in-detail analysis of objects, governing law, income and expenses of the Taxpayers¹⁵, held that, beyond a doubt, the Taxpayers perform statutory functions in the larger public interest of regulating the standards of education, leading up to the profession, prescribing standards of professional etiquette, behavior and discipline of its members. No other body has the authority in law to perform the functions and duties that the Taxpayer do. Therefore, it clearly falls in the description of a GPU.
- ▶ In cases of "statutory regulatory authorities" where the Taxpayers¹⁶ were set up under the relevant Acts and engaged in the function of certification of seeds (for farmers), such functions were held to be pertaining to GPU and not by way of trade, commerce or business.
- ▶ The tax authority shall, however, determine the nature of activities carried out by such institutions and fees charged by the same i.e., whether a higher mark-up has been charged, which may constitute the activity to be of commercial nature.
- ▶ If the regulatory body undertakes activities for "charitable purposes", the threshold given in the definition of the same for business profits shall be determined to have been complied with.
- ▶ As a note of caution, where the regulatory bodies charge consideration which is vastly or significantly higher than the costs it incurs, such income would attract the mischief of quantitative threshold and may lose the benefit of exemption.

Judgment for trade promotion bodies, councils¹⁷, associations or organisations

- ▶ Bodies involved in trade promotion (such as AEPC) or set up with the objects of purely advocating for, coordinating and assisting

¹² For instance, GIDC, MIDC, NOIDA

¹³ For instance, ICAI

¹⁴ Authorities set up under Seed Act, 1966

¹⁵ ICAI

¹⁶ The Andhra Pradesh State Seeds Certification Authority and the Rajasthan State Seeds and Organic Production certification Agency

¹⁷ For instance, AEPC

trading organizations, can be said to be involved in advancement of objects of GPU.

- ▶ However, if such organizations provide additional services such as courses meant to skill personnel, providing private rental spaces in fairs or trade shows, consulting services etc., against service fees, then income or receipts from such activities would be considered as “in relation to” business or commercial in nature and may be governed by the prescribed threshold limit under the ITL.

Judgment for non-statutory bodies¹⁸

- ▶ The fees or consideration charged by non-statutory bodies¹⁹ performing important public functions (like development of online educational and research platform, acting as an internet exchange) by adding nominal mark-up above cost may constitute charitable purpose.
- ▶ The tax authority may analyze the nature of functions performed by them on a yearly basis and also determine whether the mark-up charged on cost is nominal or substantially high.
- ▶ Another body (GS1 India), though involved in advancement of GPU, its services are for the benefit of trade and business from which it receives significantly high receipts, it is covered by mischief of the amended provisions. However, the tax authority may determine status of such entity on an annual basis and if found that its charges are at cost or with nominal mark-up, it may be considered for exemption.

Judgment for sports associations (like BCCI)

- ▶ It was urged on behalf of the tax authority that cricket associations are not carrying on any charitable activity. Reliance was placed on the facts to say that substantial amounts were received by the state associations towards their share of sale of media rights (as constituents or members of BCCI), which are commercial receipts.
- ▶ Claim of the present sport associations will not fall within “education” and will have to be examined under the residuary limb i.e., the GPU category for tax exemption.
- ▶ The SC, while observing that activities of cricket associations are run on business lines or that sale of media rights and sharing the proceeds amongst different state associations are *prima facie* commercial, did not conclude the matter. Instead, the tax authority was directed to consider the facts and, based on the same, examine the nature of activities by performing detailed scrutiny of the material on hand.

Judgment for private trusts

- ▶ Taxpayer 1²⁰ was engaged in distribution/publication of newspaper and was funded mainly through advertisements and the trust did not constitute business. It was held that the activity carried on by the Taxpayer was of the nature of GPU. Furthermore, the trust was also engaged in providing advertisement services which constituted activities in the nature of business and, hence, the threshold would be required to be met to claim the exemption.
- ▶ Taxpayer 2²¹ was a registered society with the object of establishing and running a health club, Arogya Kendra, promotion of moral values, eradication of child labor, dowry etc. It had entered into arrangements with state agencies to supply mid-day meals to students which, according to the tax authority, was not part of its objects. Since the facts of the case about coverage within objects clauses were not clear, the SC set aside the matter back to the tax authority. However, the SC noted that the tax effect in appeal did not exceed INR1m, which was within the threshold of the relevant time for filing appeal by the tax authority and receipts from the activity also did not exceed the quantitative limit of the amended provisions. Hence, the SC did not interfere with the HC’s order which had allowed appeal in favor of the Taxpayer.

¹⁸ For instance, ERNET, NIXI, GS1 India

¹⁹ ERNET and NIXI in the given case

²⁰ Tribune Trust

²¹ Shri Balaji Samaj Vikas Samiti

Comments

This SC ruling is an important development for charitable institutions in various sectors. This judgment has finally put to rest the controversy which has been raging for years on the scope of GPU test post the 2008 amendment in the ITL and has given the liberty, both to taxpayers and the tax authority, to critically evaluate each case in the light of the guiding principles enunciated in the ruling.

This SC ruling covers within its fold different industries and fields of charitable organizations, some of which are authorities, corporations or bodies established by statute such as GIDC, MIDC, NOIDA, statutory regulatory bodies/authorities such as ICAI, trade promotion bodies, councils, associations or organizations such as AEPC, non-statutory bodies such as ERNET, NIXI, GS1 India, sports associations like BCCI and private trusts.

The SC, after having traced the legislative history and its earlier rulings under unamended law, noted that the current provision of the ITL in the context of GPU is restrictive in scope owing to the negative language used, as compared to the pre-amended provision and, hence, may require different considerations. In light of the above, the SC distinguished its earlier landmark rulings in the case of Surat Silks and Thanthi Trust (supra) as pertaining to pre-amended law.

While most of the entities and activities involved in appeal before the SC qualified as GPU within the meaning of the term charitable purpose, debate surrounds the meaning of “fee cess or other consideration” and its impact on construing whether the activity answers to the description of “trade, commerce or business”. The SC held that where “fee, cess or other consideration” is statutorily fixed or where it represents recoupment of cost or cost with nominal mark-up, activity may not be construed as “trade, commerce or business” and will be excluded from mischief of commercial activity under the amended provision. If, however, “fee, cess or other consideration” charged is substantially higher over cost, it is tainted with “trade, commerce or business” and will qualify for tax exemption only if receipts are within the quantitative limit prescribed by the amended provision.

While guidance and direction of the SC are very instructive, this ruling, unfortunately, does not provide further guidance on the manner in which cost or nominal mark-up may be determined or what may be substantially higher mark-up. Since this involves subjective consideration, litigation on the practical application of this SC ruling or ratio cannot be ruled out on the field.

This SC ruling applies to charitable purposes of GPU and will have no applicability to carrying on of a business activity by trusts/institutions under other limbs of charitable purposes such as relief to the poor, education, medical relief etc.

The present SC ruling, being law of the land, will be highly useful to both taxpayers as well as tax authorities in interpreting the statutory provisions and approaching the claim of charity exemption.

