

# Education Sector Hotline

May 30, 2019

## EDUCATION TRUST DENIED TAX EXEMPTION REGISTRATION SANS CHARITABLE ACTIVITY

Recently, the Chandigarh Bench of the Income Tax Appellate Tribunal ("**Tribunal**") upheld<sup>1</sup> the denial of registration under section 12AA<sup>2</sup> of the Income Tax Act, 1961 ("**ITA**") to M/s Jiwan Dass Kartar Singh Charitable Trust ("**Trust**") which was acting as a franchisee of Zee Learn Limited ("Zee Learn") for their Kid Zee pre-school.

Under the ITA<sup>3</sup>, the income of institution generated from and applied towards a charitable purpose (as defined under section 2(15)<sup>4</sup> of the ITA) is exempt from income tax. However, a registration under section 12AA is a pre-requisite for an institution to be regarded as a charitable institution.

The denial of registration in the instant case was on the ground that the trust, through established with charitable objects, was used to run a franchise for earning profits. As there was no intent of imparting education to public at large and no charitable activity being carried out in actuality, the registration denial was upheld.

### FACTS & BACKGROUND

The Trust, whose stated object in the trust deed was the promotion of education through the establishment of educational institutions, with special emphasis on the poorer section of society, had entered into a franchise agreement ("**Franchise Agreement**") with Zee Learn to set up a school.

It applied to the tax authorities for a registration under section 12AA, which registration was denied on the following grounds:

- The essence of charity was negated by the fact that the Trust was acting as a mere agent, promoting Zee Learn's business on a commercial basis on the terms and conditions set by Zee Learn for its own benefit;
- Under the Franchise Agreement, the fee structure etc., was aligned to maximize the profits;
- Zee Learn's overarching control over the operations severely limited the ability of the Trust to pursue charitable activities independently, including giving discounts or credits to needy students;
- The entries in the P&L account of the Trust failed to evidence that any of the charitable objects of the Trust enumerated in its trust deed had actually been carried out;
- Control of the Trust lay with a single family, and the lack of representation from other sections did little to impart the character of an entity amenable to public charity.

### RULING

Upholding the denial of registration, the Tribunal found that the Trust was not engaged in any of the charitable objects set out in the trust deed.

Relying on rulings<sup>5</sup> of its Chennai Bench and the Uttaranchal High Court, the Tribunal interpreted the definition of "charitable purpose" to mean that while charitable institutions may collect fees and service charges, they may not charge fees, etc., at commercial rates uniformly without exception for the needy. Doing so would dilute the presence of real charity.

In this case, the Tribunal found that object of the Trust was to establish a number of educational institutions under a brand name and run them on commercial lines, which could not be regarded as charitable activity. Infact the Tribunal further went on to explain that merely writing aims and objectives as charitable in nature in the trust deed doesn't entitle a trust to be charitable per se. It has to be proved beyond doubt that the activities of the trust are charitable in nature and genuine. There should be some evidence to satisfy the authorities concerned before granting the registration under section 12AA of the ITA.

In the Tribunal's opinion, the Trust was running with a primary objective of earning the profits and hence registration under Section 12AA of ITA was denied.

### ANALYSIS & CONCLUSION

While section 2(15) provides that an institution set up for 'the advancement of any other object of general public utility' will cease to be a charitable purpose if it involves any trade, commerce or business, a plain reading of the proviso shows that this requirement is linked only to the residuary category, i.e., general public utility and not the first six categories.<sup>6</sup> Therefore, the benefits of sections 11 to 13A should not be denied to institutions and organizations falling within such categories merely because they carry on an activity generating profit.<sup>7</sup>

However, the tax authorities often tend to take a contrary stand and if any organization indulges in the slightest trace of any commercial activity, the tax authorities seek to deny it registration under 12AA.

The present ruling is diametrically opposite to a ruling in *Merita Welfare Trust v. CIT*<sup>8</sup>, where, on very similar facts,

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and relying on a ruling of the Supreme Court of India<sup>9</sup>, the Delhi Bench of the Tribunal gave precedence to the trust deed over the franchise agreement and ruled that the conditions of the franchiser under the franchisor agreement cannot be a ground to assume that the income of the trust will not be applied for educational activity which is charitable activity u/s 2(15) of the ITA or objects of the trust.

Several rulings have also upheld the right of a charitable institution to earn a profit, provided that profit is ancillary to and used in furtherance of its charitable purpose.

Merely entering into a franchise arrangement or earning profits therefore should not be the grounds for denial of registrations and tax benefits if charitable objects are fulfilled. The sector would do well to revisit their charter deeds and statements of objects and purpose to ensure that their charitable nature can be adequately demonstrated on paper and in practice, to secure tax benefits. It is also important to ensure that the charitable nature is not lost while entering into commercial arrangements in furtherance of the charitable purpose.

The good news is that the Tribunal's ruling is binding on tax officers in the states of Punjab and Haryana but not on the tax officers of other Indian states. Further, since these matters are fact specific, each registration grant or denial will have to be judged on the merits of its own case.

— **Joachim Saldanha & Aarushi Jain**

You can direct your queries or comments to the authors

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<sup>1</sup> *Jiwan Dass Kartar Singh Charitable Trust v. The Commissioner of Income Tax*, ITA NO. 426/Chd/2018

<sup>2</sup> Section 12AA(1) sets out the procedure for registration of a charitable institution. Before granting a registration, the tax authorities are required to determine that the objects of the institution are genuinely charitable, and may call for documents they deem necessary to make such determination.

<sup>3</sup> Sections 11 and 12

<sup>4</sup> "*charitable purpose*" is defined under section 2(15) of the ITA and 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 (provided that the advancement of any other object of general public utility does not involve carrying on any activity in the nature of trade, commerce or business, or rendering any service in relation to any trade, commerce or business, for consideration, irrespective of the nature of use, application or retention of the income from such activity or service, unless— (i) such activity is undertaken in the course of actual carrying out of such advancement of the 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).

<sup>5</sup> *Rajah Sir Annamalai Chettiar Foundation v. Commissioner of Income Tax*, 15 taxmann 313; *Commissioner of Income Tax v. National Institute of Aeronautical Engineering Educational Society*, [2009] 181 Taxman 205.

<sup>6</sup> *Hamdard Laboratories India v. Director General of Income-tax (Exemption)*, 216 Taxman 201 (Delhi)

<sup>7</sup> The Law and Practice of Income Tax, Kanga & Palhivala, Lexis Nexus, 10<sup>th</sup> Edition, Vol -1

<sup>8</sup> ITA No. 5481/Del/2013

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