

Supreme Court explains the meaning of general public utility for claiming exemption by charitable organisations

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Summary

Tax exemption¹ is available to organisations carrying on activities for 'charitable purpose', subject to the fulfilment of prescribed conditions.

The Act² defines 'charitable purposes', which includes activities for the advancement of object of General Public Utility ('GPU'), subject to certain prescribed conditions. The government has from time to time amended the definition by making additions to the eligible categories or prescribing conditions to ensure that the benefit is available only in genuine charitable cases not motivated by profit.

Various courts have interpreted the term 'GPU' widely, and by applying the 'predominant object' test, have held that carrying on of any trade, commerce or business is per se not a bar or disqualification for a GPU category charitable organisation.

The Supreme Court (SC) has in a batch of appeals, consisting of organisations from different domains, settled this controversy. SC has held that the GPU category charitable organisations are permitted to engage in commercial activities for fees, cess or any consideration only in limited situations, i.e., where such activity is carried out in course of achieving its object of GPU and the receipt from such activity is within the prescribed limit. In all other cases, such organisations are not allowed to carry out trade, commerce or business or provide services in relation thereto. While delivering the said ruling, SC also interpreted the term 'fees, cess, or any consideration' in the context of GPU category charitable organisations.

Legislative history

- Organisations engaged in philanthropic activities may avail the benefit of tax exemption under the Act³, provided the objective of such entity is charitable in nature. For this purpose, charitable activities include relief of poor, medical relief, education, yoga, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest. Charitable activity also includes 'advancement of object of GPU', which covers general public welfare. This term has been widely interpreted by various courts.
- A major amendment was brought in the definition of 'charitable purpose', regarding GPU vide Finance Act, 2008. Prior to such amendment⁴, exemption could be granted even if the charitable organisation carried on business which is incidental to primary charitable object. However, with effect from 1 April 2009, specific exclusion was provided, whereby organisations carrying on trade, commerce or business for a fees, cess or consideration exceeding the then

¹ As per Section 11 of the Income Tax Act, 1961 (the 'Act') subject to certain prescribed conditions.

² Section 2(15) of the Act

³ Section 11 of the Act

⁴ Prior to amendment vide Finance Act, 2008 (effective from 1 April 2009), Section 2(15) read as follows:

"2(15) — *charitable purpose includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility not involving the carrying on of any activity for profit.*"

prescribed limit⁵ would not be eligible for the exemption.

- Section 2(15) of the Act was later amended vide Finance Act, 2011 and Finance Act, 2015. As per the current provisions, GPU category charitable organisations would fulfil the criteria of 'charitable purpose' only if it does not engage in any trade, commerce, business or services in relation thereto for a cess, fee, or consideration. However, as an exception, income from business activity carried out in the course of attaining the object of GPU, would qualify for tax exemption, where the income is within the prescribed threshold⁶ and separate books of accounts are maintained.

Issues under consideration

- The Revenue has challenged the decisions of various High Courts (HCs) allowing the benefit of tax exemption to taxpayers from various fields such as:
 - Statutory corporations discharging public functions, such as AUDA, GIDC, GHB, etc⁷
 - Statutory regulatory bodies/ authorities such as, ICAI⁸, Andhra Pradesh State Seeds Certification Authority, etc
 - Trade promotion bodies, such as AEPC⁹
 - Non-statutory bodies¹⁰, such as ERNET, NIXI and GS1
 - Sports/ cricket associations, such as BCCI¹¹ and state cricket associations
 - Private trusts

- In these cases, the HCs held that carrying on of any activity in the nature of trade, commerce or business does not by itself disqualify GPU category charitable organisations to avail tax exemption.
- HCs placed reliance on several judgements on the matter. Some of the key judgements are as under:
 - **Surat Art**¹² - This ruling propounded the 'predominant object' test for determining whether a trust falls under GPU category charitable purpose or not. It was held that if the predominant object is to carry out charitable activities, then earning profits would not *per se* disqualify the entity for claiming tax exemption. It laid down that to qualify as an entity for 'charitable purpose', its activities should not be driven by profit motive.
 - **Thanthi Trust**¹³ - It was held that business income of the trust would be exempt since the business is incidental to attainment of its main objectives. Further, it was held that the application of business income for achieving the charitable objects of the trust would qualify as 'incidental' to the attainment of its main objectives.

Taxpayer's contentions

- Certain taxpayers are institutions/ corporations¹⁴ established by or under the statues enacted by the government. Respective parent enactment under which these institutions / corporations

⁵ Aggregate value of business receipts to be not more than INR 10 lakhs (in lieu of retrospective amendment made vide Finance Act, 2010)

⁶ Business receipts should not exceed 20% of the total receipts of the entity.

⁷ Ahmedabad Urban Development Authority (AUDA), Gujarat Industrial Development Corporation (GIDC) and Gujarat Housing Board (GHB)

⁸ Institute of Chartered Accountants of India (ICAI)

⁹ Apparel Export Promotion Council (AEPC)

¹⁰ Education and Research Network (ERNET), National Internet Exchange of India (NIXI) and GS1 India (GS1)

¹¹ Board of Cricket Council of India (BCCI)

¹² ACIT vs Surat Art Silk Cloth Manufacturers' Association [1980] (2 SSC 31)

¹³ ACIT vs Thanthi Trust [2001] (2 SCC 707)

¹⁴ viz. AUDA, GIDC, GHB, etc.

were created, entirely govern their functioning. This may also include certain stipulations, such as, maintenance of separate fund for surplus earned, if any, for the purpose of further development and expansion of activities by such entities. It was contended that surplus generated, if any, will be utilised only for furtherance of the objectives of the respective law. Hence, it cannot be construed that such entity is carrying on any trade, business, or commerce.

- Article 289 of the Constitution of India (COI) exempts states' property and income from union taxation. To permit levy of income tax on cess or fee collected by a state would violate Article 289 of COI in the context of state undertakings.
- Reliance was placed on the ratio laid down in *Surat Art (supra)* and *Thanthi Trust (supra)* to contend that if the activities involved are 'mainly' charitable and for advancement of the object of GPU. Its purposes are deemed to be charitable even if it carries on some business or trade-like activities.
- Qualification conditions¹⁵, in case of GPU category charitable organisations, is attracted only if the predominant objectives are in the nature of trade, commerce, or business carried on for a fee, cess, or other consideration. Thus, if the main activity is not 'business', the connected, incidental, or ancillary activities carried out in furtherance of and to accomplish the main objective would not normally amount to business.

- The legislative intent behind the amendments was to curtail the abuse of exemption by organisations that masquerade as charitable, but in reality are carrying on business. Genuine charitable organisations that undertake trade-like activities and generate surplus for their sustenance could not be denied the benefit of tax exemption¹⁶.
- Further, it was argued that for an activity, to be regarded as 'trade, commerce or business', it is vital that it must be profit-driven¹⁷.

Revenue's contentions

- The old Act¹⁸ did not contain any restrictive expressions forbidding trade or business activities by charitable organisations. Thus, the contextual framework of earlier decisions¹⁹ by the SC were entirely different.
- In changing the law, the parliament's intent was to not provide exemption to entities involved in trade or business and mitigate abuse of benefit by businesses claiming to be driven by charitable purposes. The Revenue submitted that before the decision of *Surat Art (supra)*, two legislative developments took place. Thus, in case of *Surat Art (supra)*, the constitution bench erroneously held that where the 'predominant' activity is to promote object of GPU, tax exemption would be available.
- GPU category charitable organisations are permitted to carry out business only if it is in course of attaining charitable objectives, subject to the prescribed threshold. Further, proceeds from trade

¹⁵ First proviso to Section 2(15) of the Act

¹⁶ Reliance was placed on Central Board of Direct Taxes (CBDT) Circular 11/2008 dated 19 December 2008 and Finance Minister's speech during the Finance Budget, 2008

¹⁷ Reliance was placed on the decision of *State of A.P v. H. Abdul Bakhi & Bros (1964) (7 SCR 664)*

¹⁸ The Income-tax Act, 1922 (the 'old Act')

¹⁹ *The Trustees of Tribune Press, Lahore v. CIT, Punjab [(1939) 7 ITR 415]*, *Commissioner of Income Tax v P Krishna Warriar [(1964) 8 SCR 36]* and *CIT v. Andhra Chamber of Commerce [(1965) 1 SCR 565]*

cannot be claimed to be exempt merely because they are ploughed back to feed the charitable objective.

- The critical factor here is not the status of the entity but the nature of activity carried by it. If the nature of activity is trade or business with a profit motive, then the same can be taxed even if it is carried by the state or its instrumentalities. Article 289 of the COI does not grant absolute immunity from taxation.

Key observations of SC

- **Interpretation of Section 2(15) of the Act**

- The SC held that GPU category charitable organisations cannot engage in any activity in the nature of trade, commerce, or business or service in relation to such activities for consideration (including a statutory fee, etc.). This prohibition has been relaxed to a limited extent and is subject to a threshold.
- The SC referred to the legislative history, the Finance Minister's speech in the Parliament and departmental circulars²⁰ to interpret the meaning of 'charitable purpose' post amendment vide the Finance Act, 2008 and taking into consideration the subsequent changes.
- The SC observed that the intent of the amendments was to alter the regime applicable to GPU category charitable organisations. Legislature has established its intent by

expressly deleting the phrase 'activity for profit'²¹ and enacting an expanded list of activities prohibited for GPU category charitable organisations, which would be essential to retain its charitable character.

- The scheme of tax exemption concerning GPU category charitable organisations applies in a four-fold manner:
 - a) bar on engaging in trade, commerce or business activities;
 - b) bar on providing services in relation to trade, commerce or business;
 - c) above two activities are undertaken for a fee, cess or any other consideration; and
 - d) above mentioned restrictions shall apply even if the income from such activities is ploughed back to feed on charitable objectives.
- Decision in the case of Surat Art (*supra*) was distinguished, as it no longer stands good due to amendments in the law. Similarly, the decision in the case of Thanthi Trust (*supra*) was also distinguished on the basis that the said trust was involved in 'education' and advancing GPU is not its objective.
- The SC affirmed its earlier decision²², and held that not every state activity resembling commerce may be considered exempt from tax. In addition, mere sale or lease of

²⁰ Circular No. 1/2009 dated 27 March.2009 and Circular No. 11/2008 dated 19 December 2008

²¹ Section 2(15) as it came into force on 01 April 1962 was defined as follows:

"(15) — *charitable purpose includes relief of the poor, education, medical relief, and the advancement of any other*

object of general public utility not involving the carrying on of any activity for profit."

Later, w.e.f. 01 April 1984, the expression 'not involving the carrying on of any activity for profit' was omitted.

²² New Delhi Municipal Council v. State of Punjab (1997) (7 SCC 339)

government property does not imply trade or business. The crucial or determinative element in a venture is whether performance of a function is driven by profit motive.

- **Distinction between business held under the trust²³ and trust carrying on business²⁴**

- In case of the former, tax exemption may be available if business undertaking is itself a property held under the trust for charitable or religious purpose. Property in the form of business may be settled by the settlor or donor in the trust. Income from such business would be tax exempt subject to fulfilling the prescribed conditions.
- However, latter is the case where the trust itself carries on business. In this case, business income would be eligible for tax exemption only where the business is incidental or ancillary to attainment of the objectives of the trust and separate books of accounts are maintained. This would be in addition to meeting the prescribed conditions.

- **Interpretation of the expression ‘incidental’ in the Act²⁵**

- Section 11(4A) of the Act states that business should be incidental to the objectives of the Trust.

The definition of ‘charitable purpose’ in the Act²⁶ states that the GPU category charitable organisations are generally not permitted to carry on any activity in nature of trade, commerce, or business (incidental or not). However, such activities are permitted only if the same are carried

out in the course of attaining GPU objective and receipts are within the prescribed limits.

- It is clarified that provisions of Section 11(4A) and Section 2(15) of the Act ought to be construed harmoniously.
 - The correct way of reading reference to the term ‘incidental’ in Section 11(4A) is to interpret it in the context of activities in the nature of business, trade, commerce, or service (in relation thereto), which are conducted in the course of attainment of the GPU objective. Thus, income, profit or surplus generated from such activities would be ‘incidental’.
- **Scope of consideration and profit motive**
 - The Act does not only envisage pure charity, i.e., charitable activities with no consideration. Where GPU category charitable organisations involve incidental activities with a consideration, it can be granted exemption provided the receipts from such activities are within the prescribed threshold.
 - The phrase ‘fee, cess, and any other consideration’ must receive a purposive interpretation. Regulatory activity, necessitating fee or cess collection in terms of the enacted law, or collection of amounts in furtherance of activities such as education, regulation of profession, etc., may not automatically be regarded as business or commercial in nature. Similarly, statutory boards and authorities, which are under

²³ Section 11(4) of the Act

²⁴ Section 11(4A) of the Act

²⁵ Section 11(4A) of the Act

²⁶ Section 2(15) of the Act

mandate to develop housing, industrial and other estates at reasonable or subsidised costs and which might entail charging higher amounts from some section of the beneficiaries to cross-subsidise the main activity, cannot be characterised as engaging in business.

- Where a fee or consideration charged for an activity (advancing GPU objective) is nominal and only covers the cost (including administrative expenses) or includes a nominal mark-up, it cannot be construed to be ‘trade, commerce, or business’. However, where the fees charged for an activity is substantial or significantly above cost, such activity would fall within the ambit of ‘trade, commerce, or business’.
- The SC also provided certain instances where even though consideration is charged, it would not be construed to be in the nature of business income. This includes providing low-cost hotels, renting marriage halls for low amounts, blood bank services with fees only to cover costs, etc.

Considering the above principles, the SC has analysed the eligibility to claim tax exemption under GPU category charitable organisations for the following category of taxpayers:

Sr. No.	Type of organisation	SC ruling
1	Statutory corporations discharging public functions	<ul style="list-style-type: none"> • Income and receipts are arising on account of performing essential public functions. Accordingly, even though it may resemble trade, commercial, or business activities, it is essential for advancement of public purposes/ functions. • Such receipts are <i>prima facie</i> to be excluded from the mischief of business or commercial receipts. However, tax authorities are directed to determine the nature of activities carried out and fees charged for the same. • If the consideration or fees charged is significantly higher than the costs incurred, such income would be subject to the prescribed quantitative threshold²⁷ and may lose benefit of tax exemption. • The central government may, on a case-to-case basis, decide whether and to what extent exemption can be awarded to such bodies by notifying them²⁸.
2	Statutory regulatory bodies/ authorities	<ul style="list-style-type: none"> • Income and receipts of statutory regulatory bodies are on account of performing exclusive duties, which are in larger public interest, such as: <ul style="list-style-type: none"> - prescribing the curriculum; - disciplining professionals; and - prescribing standards of professional conduct. • These are not <i>prima facie</i> business or commercial receipts. • However, the tax authorities are directed to determine the nature of activities carried out and fees charged for the same. • If the consideration or fees charged is significantly higher than the costs incurred, such income would be subject to the prescribed quantitative threshold²⁹ and may lose benefit of tax exemption.

²⁷ As per proviso to section 2(15) of the Act

²⁸ Under Section 10(46) of the Act

²⁹ As per proviso to section 2(15) of the Act

Sr. No.	Type of organisation	SC ruling
3	Trade promotion bodies	<ul style="list-style-type: none"> • General activities of trade promotion bodies, i.e., to assist and support trade organisations, may fall under GPU. • However, tax authorities would have to apply similar tests to determine the nature of activities carried out and fees charged for the same. • Where such bodies receive consideration for providing additional services, such as courses meant to skill personnel, private rental spaces in fairs or trade shows, consulting services, etc., would be business or commercial in nature. In such a case, tax exemption would be granted if the conditions mentioned in the proviso to Section 2(15) of the Act are being fulfilled.
4	Non-statutory bodies viz., ERNET and NIXI	<ul style="list-style-type: none"> • These bodies are engaged in important public functions and are driven by charitable purposes. • However, tax authorities need to ascertain on an annual basis, the nature of activities and whether the fees charged include a nominal mark-up in order to be regarded as activity for charitable purpose.
5	Non-statutory bodies viz., GS1	<ul style="list-style-type: none"> • It is a non-statutory body involved in advancement of object of GPU. • However, the consideration received for its services are commercial in nature and are also significantly high. Accordingly, its claim for exemption cannot succeed considering the amended provisions of Section 2(15) of the Act. • In future, if GS1 is able to prove that the amount charged to its customers is on a cost-to-cost basis with at most a nominal mark-up, the claim for tax exemption should be independently assessed.
6	Cricket associations	<ul style="list-style-type: none"> • Activities of cricket associations are run on commercial lines. • SC directed the tax authorities to consider the facts of the case, and based on the same, examine the nature of activities by performing a detailed scrutiny of the material on hand.

Sr. No.	Type of organisation	SC ruling
7	Private trusts	<ul style="list-style-type: none"> • SC observed that the taxpayer trust, in this case, was engaged in publication and distribution of newspapers. • It was mainly funded from advertisement income received by it. The SC observed that it cannot claim exemption, as records reveal such income constituted business or commercial receipts. • Further, GPU category charitable organisations can be eligible for tax exemption only if it is engaged in incidental business or commercial activities and receipts from such activities do not exceed the prescribed threshold.

- **Clarification by the SC regarding applicability of this ruling³⁰**

Subsequently, Revenue sought clarification regarding the applicability of this ruling and SC clarified that this ruling shall be applicable in the following manner:

- **For the batch of cases adjudicated in the current appeal:** The ruling would be considered as final for the respective assessment years (AYs) seven if it is against the Revenue; and
- **For cases not covered by this decision:** In case of future application, Revenue would be required to apply the law declared by this ruling, considering the facts of each case on year-on-year basis.

³⁰ [2022] 144 taxmann.com 78 (SC)

Our comments

This SC decision is a comprehensive ruling on GPU category charitable organisations. It has put to rest several controversies on laws regarding tax exemption under the GPU category, such as incidental business, interpretation and scope of 'trade, commerce or business and services in relation thereto for a fee, cess or consideration' and commercial activities that can be undertaken by charitable organisations.

The judgement also provides an in-depth analysis of what constitutes incidental business activities and elucidates on qualification conditions. While delivering the ruling, the SC has discussed the legislative history and evolution of tax exemption laws for charitable organisations to establish the intent of the parliament. It has also distinguished its earlier ruling by the constitution bench in the case of *Surat Art (supra)* in the context of present law.

The SC has also deliberated on the availability of tax exemption to different types of charitable bodies, such as statutory organisations, regulatory bodies, trade associations, etc., under GPU category. The entity wise factors outlined by the SC in this judgement act as a guideline for tax exemption. The principles enunciated in this ruling can also assist other GPU category charitable entities to determine their eligibility to claim tax exemption.

Further, SC has subsequently clarified regarding the applicability of this ruling. Such clarification would mitigate the risk of tax authorities re-doing the assessments for the covered AYs, especially where the verdict is in favour of the taxpayer.

However, it is pertinent to note that there are still grey areas, such as, what is the meaning of the term 'nominally marked-up consideration', which are the relevant factors for deciding whether an activity carried out by the trust / institution can be considered as activity carried out 'in the course of carrying out its objectives'.

Accordingly, taxpayers may need to assess the impact on the facts of their case and evaluate the way forward.

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