

# INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

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Volume 7 | Issue 3

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2024

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# Tax on the Income of Public Trust with special reference to Educational Institutions in India

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## ABSTRACT

*A charitable trust is created for the benefits of the public at large. Exemption from the tax given to the charitable trust because their object is to serve mankind. Sometimes trust was formed for a charitable purpose but along with it, they are also engaged in the business or commercial activities, in such case it would be difficult to draw the distinction between income applied for charitable purposes or, business or commercial activities. Education has also come under the meaning of charitable purposes; therefore, educational institutions are also entitled to get an exemption from the tax. Where an educational institution generates a surplus and invests in fixed assets which were properties of educational institution, exemption from the tax should not be refused. If the educational institution ploughed back the surplus for educational purposes or used the new assets for educational purposes, then said the educational institution was considered to have existed solely for educational purposes only and not for profit.*

**Keywords:** Public Trust, Education, Exemptions, Income Tax, Assessee.

## I. INTRODUCTION

Public trust as the name denotes is a trust settled or created for the welfare and benefit of the public at large. The public trust generally has a philanthropic objective and therefore exemption from income tax is given to them by the Government under the Income Tax Act, 1961. The taxation of a charitable trust is governed by Chapter III of the Income Tax Act, 1961 *inter alia* including Sections 11, 12, 12A, 12AA, and 13 of the Income Tax Act, 1961. The Government of India has given various exemptions to charitable and religious trust keeping in view of the services rendered by them.

However, in certain cases, a trust which was formed as a public charitable trust engages itself into business or commercial activities along with charitable activities, in which case an issue may arise that whether the income of such public trust is also entitled to the tax benefits under the Income Tax Act, 1961? or as a corollary, whether profit or surplus generated out of the

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commercial activities of public trust is chargeable to tax?

### (A) Meaning of trust and kinds of trust

The term “trust” is not defined under the Income Tax Act, 1961. A trust is an obligation annexed to the ownership of property. However, all obligations do not constitute trust. It is only a particular type of obligation which arises out of confidence reposed in and accepted by the owner that results in a trust. The source of obligation is, therefore, the confidence reposed by a person in the owner and accepted by the owner. The owner must accept the obligation annexed with the ownership of the property for the benefit of another.<sup>2</sup>

Trust can be broadly classified into two categories viz. public trust and private trust. Private trust is a trust which is created for benefit of an individual or class of individual. In case of private trust, the beneficiaries are an ascertained body of persons. Public or charitable trust, on the other hand, is a trust for the benefit of public at large or some considerable portion of the public answering a particular description. It may be noted that it is not the number but the character of charities which determines as to whether a trust is a public or private.<sup>3</sup>

## II. EXEMPTION OF TAX UNDER SECTION 11 OF THE INCOME TAX ACT, 1961

As stated earlier, due to the nature of activities undertaken by public trusts, certain public trusts are entitled to taxation benefits. Section 11 of the Income Tax Act, 1961<sup>4</sup> exempts the income of the following trusts from income tax:

<sup>2</sup> S Krishnamurthi Aiyer and S K Sarvaria, *Commentary on the Indian Trusts Act* (9<sup>th</sup> ed. Universal Law Publishing 2017) 11.

<sup>3</sup> Deoki Nandan v Murlidhar AIR, [1957] SC 133.

<sup>4</sup> The Income Tax Act, 1961, s 11.

(1) Subject to the provisions of sections 60 to 63, the following income shall not be included in the total income of the previous year of the person in receipt of the income—

(a) income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of fifteen per cent of the income from such property;

(b) income derived from property held under trust in part only for such purposes, the trust having been created before the commencement of this Act, to the extent to which such income is applied to such purposes in India; and, where any such income is finally set apart for application to such purposes in India, to the extent to which the income so set apart is not in excess of fifteen per cent of the income from such property;

(c) income derived from property held under trust—

(i) created on or after the 1st day of April, 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and

(ii) for charitable or religious purposes, created before the 1st day of April, 1952, to the extent to which such income is applied to such purposes outside India;

Provided that the Board, by general or special order, has directed in either case that it shall not be included in the total income of the person in receipt of such income;

(d) income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

(1) A charitable trust

(2) A religious trust,

However, the word “trust “as used in the context of section 11 to13 of the Income Tax Act, includes in addition to the ‘trust’ any other legal obligations.

Trust itself is a legal obligation, as the trustees are legally bound to apply the income of the trust in the manner and for the purposes specified by the author of the trust and it includes the following:

- (i) Property of the estate of deceased held by the executor(s) under a legal obligation.
- (ii) Companies or Guarantee Companies. Such companies are also holding the properties under legal obligation.
- (iii) Muslims Wakfs.
- (iv) Religious Endowments under the Hindu Law.
- (v) Institutions registered under the Societies Registration Act, 1860 as the properties of the society are held under a legal obligation.
- (vi) Bar councils, Chamber of commerce, endowments, monasteries, maths etc. are all instances where the ‘property is held under legal obligations.’<sup>5</sup>

#### **(A) Meaning of Public or Charitable trusts**

The expression “charitable purpose” has been defined under Section 2(15) of the Income Tax Act, 1961 to include:

- (a) relief of the poor,
- (b) education,
- (c) medical relief,
- (d) preservation of environment (including water sheds, forests and wild life,
- (e) preservation of monuments or places or objects of artistic or historic interest,
- (f) Yoga and any other object of public utility.

Furthermore, in the case of *CIT v. Pamsell*<sup>6</sup> the court held that following ‘trust’ would be considered to be public charitable trust:

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<sup>5</sup> Girish Ahuja and Ravi Gupta, *A Compendium of Issues on Income Tax*(10<sup>th</sup> ed. Wolters Kluwers 2019)1419.

<sup>6</sup> *CIT v Pamsell*, [1891] AC 496.

- (i) Trust for the relief of poor.
- (ii) Trust for the advancement of education.
- (iii) Trust for the advancement of religion.
- (iv) Trust for other purposes beneficial to the community, not falling under any of the preceding heads.

In the case of *C.I.T. v. Tollygunge Club*<sup>7</sup>, Supreme Court held that to get exemption u/s. 11 of the Income Tax Act, 1961 the Trust Deed shall specifically contain the following provisions:

- (a) the benefits of the trust are open to all, irrespective of caste, creed, religion and sex
- (b) no activities of the trust will be carried out outside India
- (c) any amendment to the Trust Deed will be carried out only with the approval of the competent authority
- (d) the trust is irrevocable
- (e) in the event of the trust not being able to function in fulfilment of its objects the trustee shall, after discharging all liabilities transfer the entire assets of the trust to any other public charitable institution having similar objects
- (f) The income and the funds will be solely utilized towards the objects
- (g) The trust will not carry on any activity with the intention of earning profit.

It is pertinent to note that benefit under section 11 of the Income tax Act is not available *suo moto* to all public trusts satisfying aforementioned criteria but, in order to avail the benefits, the trust must be registered with the Principal Commissioner or Commissioner of Income tax under Section 12AA.

### III. CHARITABLE PURPOSES ALONG WITH COMMERCIAL ACTIVITIES

Sometime a trust that was formed for charitable purpose also carries on commercial activities. In that case a question may arise whether such a trust is entitled to get the benefit of tax exemption under section 11 of the Income Tax Act, 1961?

In the case of *East India Industries (Madras) Private Ltd. v. C.I.T.*<sup>8</sup>, the trust was established for various objects, one of which was to manufacture, buy, sell and distribute pharmaceutical, medicinal, chemical and other preparations and other articles. The objects included several

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<sup>7</sup> CIT v Tollygunge Club , (1977) 107 ITR 776 (SC).

<sup>8</sup> East India Industries (Madras) Private Ltd. v CIT, [1967] 65 ITR 611 SC.

charitable and religious purposes. One of the clauses of the trust deed provided that the objects shall be independent of each other and the trustee shall have power to apply the whole or any part of the trust property or fund whether capital or income, in carrying out all or any of such objects of the trust as the trustees may deem fit. It was held by the Supreme Court that as the trustees could under the deed validity spend the entire income of the trust in carrying on business of manufacture, sale and distribution of medicinal and other preparations, which act was neither charitable nor religious, the trust property was not held for religious or charitable purposes within the meaning of the Income Tax Act, 1961.

In the case of *C.I.T. v. Andhra Chamber of Commerce*<sup>9</sup>, the Supreme Court held that if the primary or dominant purpose of a trust is charitable, another object which by itself may not be charitable but which is merely ancillary or incidental to the primary or dominant purpose would not prevent the trust from being a valid charity. In the other words we have to look into the dominant purposes of the trust. If the trust along with charitable purpose also carrying out commercial activities and the dominant purpose of the trust is charitable then the trust entitled to get the benefit of section 11 of Income Tax Act.

Prior to Assessment Year 2009-10, business income of a charitable trust or institution was also eligible for exemption subject to conditions that such business should be incidental to the attainment of its objects, and that separate books of account are maintained for such business.

With effect from 01.04.2009 (*i.e.*, from assessment year 2009-10 onwards), however, the “advancement of any other object of general public utility” shall not qualify as a “charitable purpose” if the same involves the carrying on of any activity in the nature of trade, commerce or business, or rendering of any service in relation to any trade, commerce or business, for a consideration. This new restriction applies irrespective of the nature of use or application of the income arising from such activity.<sup>10</sup>

However, the rigour of this amendment has been reduced somewhat by a subsequent amendment brought in by the Finance Act, 2010 (with retrospective effect from 1-4-2009) to the effect that the said restriction shall not apply if the aggregate value of receipts from such activity during the given financial year does not exceed Rs. 25,00,000.<sup>11</sup>

#### **IV. AMENDMENT MADE BY THE FINANCE ACT, 2015 W.E.F. AY 2016-17**

The Act has merged the first and second provisos given under section 2(15) relating to the

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<sup>9</sup> CIT v Andhra Chamber of Commerce, [1965] 55 ITR 722 SC.

<sup>10</sup> Finance Act, 2009 Proviso 1 to s 2(15).

<sup>11</sup> Finance Act, 2010 second proviso to s 2(15).

definition of charitable purpose to provide that the advancement of any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of the activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to 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 20% of the total receipts, of the trust or institution undertaking such activity or activities, for the previous year.

In the case of *DIT(E) v. Lala Lajpatrai Memorial Trust*<sup>12</sup>, Bombay tribunal held that if the predominant object of the educational trust is to carry out a charitable purpose and not to earn profit, the purpose would not lose its charitable character merely because some profit arises from the activity. Therefore, exemption cannot be denied under section 11 Income tax Act, to an educational trust if it let out its auditorium for educational activities.

In the case of *DDIT v. Institute of Chartered Accountants of India*,<sup>13</sup> Delhi tribunal held that ICAI is an educational institute and its coaching activities fall within meaning of charitable purpose under section 2(15), hence it is entitled to exemption under section 11.

In the case of *Mudra Foundation for Communication Research and Education v. CCIT*<sup>14</sup>, Gujarat tribunal held that where the assessee institution was engaged in imparting higher and specialized education in field of communication including advertising and its related subjects and gave training to individual as well as persons sent by companies to meet needs of Indian industry and commerce, it was held that such activity does not amount to services in relation to trade, commerce and industry. It amounts to imparting education and it will still be held that the institution exists solely for educational purpose.

In the case of *CIT(Exemptions) v. Fertilizers Association of India*<sup>15</sup>, Delhi tribunal held that mere charging of fee from members or non-members for rendering services like training, conducting seminars would not ipso-facto lead to denial of exemption under section 11, when dominant object of assessee remained charitable and aforesaid activities were only incidental to

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<sup>12</sup> DIT(E) v Lala Lajpatrai Memorial Trust, [2016] 383 ITR 345Bom.

<sup>13</sup> DDIT v Institute of Chartered Accountants of India, [2016] 70 taxmann.com 54 Del. Trib.

<sup>14</sup> Mudra Foundation for Communication Research and Education v CCIT, [2016] 237 Taxman 139 Guj.

<sup>15</sup> CIT(Exemptions) v Fertilizers Association of India, [2017] 399 ITR 209 Del.

main activity of assessee.

In the case of *CIT v. Animal Care Society*<sup>16</sup>, Supreme court held that where assessee incurred less than Rs. ten lakhs towards animal care such as food, medical etc. said activities would clearly be included under provisions of section 2(15).

**Will an education institution be entitled for an exemption u/s.11 of the Income Tax Act, 1961, if it generates a surplus in its account after meeting all expenses toward imparting education?**

Educational institution engages in imparting education and after paying all the expenses toward imparting education earned profit or surplus amount, then the question may arise that whether they are liable to pay tax on it or entitled for tax exemption.

In the case of *CIT v. Surat Art Silk Cloth Manufacturers' Association*<sup>17</sup>, it has been held by Supreme Court that test of predominant object of the activity is to be seen whether it exists solely for education and not to earn profit. However, the purpose would not lose its character merely because some profit arises from the activity. That, it is not possible to carry on educational activity in such a way that the expenditure exactly balances the income and there is no resultant profit, for, to achieve this, would not only be difficult of practical realisation but would reflect unsound principles of management. In order to ascertain whether the institute is carried on with the object of making profit or not it is the duty of the prescribed authority to ascertain whether the balance of income is applied wholly and exclusively to the objects for which the applicant is established.

In the case of *Aditanar Educational Institution v. CIT*.<sup>18</sup>, Supreme Court held that, "After meeting the expenditure, if any surplus result incidentally from the activity lawfully carried on by the educational institution, it will not cease to be one existing solely for educational purpose since the object is not one to make profit. The decisive or acid test is whether on an overall view of the matter, the object is to make profit. In evaluating or appraising the above, one should also bear in mind the distinction between the corpus, the objects and powers of the concerned entity.

In the case of *Oxford University Press v. CIT*<sup>19</sup>, Supreme Court held that in deciding the character of the recipient, it is not necessary to look at the profits of each year, but to consider the nature of the activities undertaken in India. If the Indian activity has no correlation with education, exemption has to be denied. Therefore, the character of the recipient of income must

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<sup>16</sup> *CIT v. Animal Care Society*, (2018) 259 Taxman 349 (SC).

<sup>17</sup> In *CIT v. Surat Art Silk Cloth Manufacturers' Association*, (1980) 2 SCC 31.

<sup>18</sup> *Aditanar Educational Institution v CIT*, [1997] 3 SCC 346.

<sup>19</sup> *Oxford University Press v CIT*, [2001] 3 SCC 359.



have character of educational institution in India to be ascertained from the nature of the activities. If after meeting expenditure, surplus remains incidentally from the activity carried on by the educational institution, it will not cease to exist solely for educational purposes. In other words, existence of surplus from the activity will not mean absence of educational purpose. The test is—the nature of activity. If the activity like running a printing press takes place it is not educational. But whether the income/profit has been applied for non-educational purpose has to be decided only at the end of the financial year.

The Supreme Court in the case of *Queen's Educational Society v. CIT*<sup>20</sup>, held that even though the surplus was made by educational institution but it was ploughed back for educational purposes. Hence said institution was held to be existed solely for educational purpose and not for purpose of profit.

Further CBDT Circular No.14 / 2015 dated August 17<sup>th</sup>, 2015, provides that mere generation of surplus out of gross receipts cannot be a basis for rejection of application u/s.10 (23C) (vi) on the ground that it amounts to an activity of the nature of profit making. The third Proviso to the said clause clearly provides that accumulation of income is permissible subject to the manner prescribed therein provided such accumulation is to be applied “wholly and exclusively” to the objects for which it is established.

In the case of *Malikarjun School Society v. CCIT*<sup>21</sup>, Uttarakhand tribunal held that merely because surplus earned by assessee educational institution was invested for expansion of school building, it could not be held that assessee did not exist solely for educational purpose so as to deny assessee exemption under section 10(23C) (vi).

In the case of *CIT v. Managing Committee, Arya High School, Mausa Punjab*<sup>22</sup>, Supreme Court held that where assessee educational society had utilised its income for purchase of land for further extension of school building, which was for educational purpose only, exemption under section 10(23C) (vi) could not be denied.

Thus, the law under Section 10(23C) (iiiad) and (vi)<sup>23</sup> may be summed up as follows - where

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<sup>20</sup> *Queen's Educational Society v CIT*, [2015] 55 taxmann.com 255 SC.

<sup>21</sup> *Malikarjun School Society v CCIT*, [2018] 90 taxmann.com 160Uttarakhand.

<sup>22</sup> *CIT v Managing Committee, Arya High School, Mausa Punjab*, [2019] 261 Taxman 450SC.

<sup>23</sup> The Income Tax Act, 1961, s10 (23C).

(iiiab) any university or other educational institution existing solely for educational purposes and not for purposes of profit, and which is wholly or substantially financed by the Government; or

(iiiac) any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit, and which is wholly or substantially financed by the Government.

*Explanation.*—For the purposes of sub-clauses (iiiab) and (iiiac), any university or other educational institution,

an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit. The predominant object test must be applied - the purpose of education should not be submerged by a profit-making motive. A distinction must be drawn between the making of a surplus and an institution being carried on "for profit". No inference arises that merely because imparting education results in making a profit it becomes an activity for profit. If after meeting expenditure, a surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes. The ultimate test is whether on an overall view of the matter in the concerned assessment year the object is to make profit as opposed to educating persons.

In the case of *New Noble Educational Society v. Chief Commissioner of Income tax*<sup>24</sup>, Supreme Court held that the requirement of the charitable institution, society or trust etc., to 'solely' engage itself in education or educational activities, and not engage in any activity of profit, means that such institutions cannot have objects which are unrelated to education. In other words, all objects of the society, trust etc., must relate to imparting education or be in relation to educational activities. Where the objective of the institution appears to be profit-oriented, such institutions would not be entitled to approval under Section 10(23C) of the Income Tax Act, 1961. At the same time, where surplus accrues in a given year or set of years per se, it is not a bar, provided such surplus is generated in the course of providing education or educational

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hospital or other institution referred therein, shall be considered as being substantially financed by the Government for any previous year, if the Government grant to such university or other educational institution, hospital or other institution exceeds such percentage of the total receipts including any voluntary contributions, as may be prescribed, of such university or other educational institution, hospital or other institution, as the case may be, during the relevant previous year; or

(iiiad) any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed; or

(iiiiae) any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit, if the aggregate annual receipts of such hospital or institution do not exceed the amount of annual receipts as may be prescribed; or

(iv) any other fund or institution established for charitable purposes which may be approved by the prescribed authority, having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States; or

(v) any trust (including any other legal obligation) or institution wholly for public religious purposes or wholly for public religious and charitable purposes, which may be approved by the prescribed authority, having regard to the manner in which the affairs of the trust or institution are administered and supervised for ensuring that the income accruing thereto is properly applied for the objects thereof;

(vi) any university or other educational institution existing solely for educational purposes and not for purposes of profit, other than those mentioned in sub-clause (iiiab) or sub-clause (iiiad) and which may be approved by the prescribed authority;

<sup>24</sup> *New Noble Educational Society v. Chief Commissioner of Income tax*, [2022]143 taxmann.com 276 (SC)

activities. The reference to ‘business’ and ‘profits’ in the seventh proviso to Section 10(23C) and Section 11(4A) merely means that the profits of business which is ‘incidental’ to educational activity – i.e., relating to education such as sale of text books, providing school bus facilities, hostel facilities, etc. e. The reasoning and conclusions in *American Hotel* (supra) and *Queen’s Education Society* (supra) so far as they pertain to the interpretation of expression ‘solely’ are hereby disapproved. The judgments are accordingly overruled to that extent. While considering applications for approval under Section 10(23C), the Commissioner or the concerned authority as the case may be under the second proviso is not bound to examine only the objects of the institution. To ascertain the genuineness of the institution and the manner of its functioning, the Commissioner or other authority is free to call for the audited accounts or other such documents for recording satisfaction where the society, trust or institution genuinely seeks to achieve the objects which it professes. The observations made in *American Hotel* (supra) suggest that the Commissioner could not call for the records and that the examination of such accounts would be at the stage of assessment. It was also held that wherever registration of trust or charities is obligatory under state or local laws, the concerned trust, society, other institution etc. seeking approval under Section 10(23C) should also comply with provisions of such state laws. This would enable the Commissioner or concerned authority to ascertain the genuineness of the trust, society etc. This reasoning is reinforced by the recent insertion of another proviso of Section 10(23C) with effect from 01.04.2021.

#### **(A) Changes brought by Finance Act, 2022**

It was seen in lots of case institutions registered as charitable one and also get the benefits of tax exemption but they do not apply their income for charitable purposes. In order to prevent the misuse by the charitable trust Finance Act, 2022 provided that in any financial year a trust or institution is required to apply at least eighty-five per cent of its income. The term ‘application’ means actually spent or paid. Where during any previous year, any sum has been claimed to have been applied by such trust, such sum shall not be allowed as application in any subsequent previous year.

## **V. CONCLUSION**

Administratively, it is not possible for any educational institution to manage their affairs in such a manner that the income exactly equates with the expenditure. Merely because an educational institution accumulates income or left out with surplus in its account after meeting all expenditure or used the surplus for the purchase any assets for educational purpose, it does not mean that they are not existed for the purpose of profit. If the institution applied the profit for

educational purpose only then they entitled to get the exemption from the tax, such institution is considered to be existed solely for educational purpose and not for profit. The exemption can be lost if application of income for purposes other than education, at the same time there is need to put restrictions on those educational institutions who are in the name of charitable activities in a covert manner to avoid paying tax on the income.

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