REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.5167 OF 2008

M/S. QUEEN'S EDUCATIONAL SOCIETY …APPELLANT

VERSUS

COMMISSIONER OF INCOME TAX …RESPONDENT

WITH

C.A. NO.5168 OF 2008

C.A. NO.8962 OF 2010

C.A. NO.909 OF 2011

CIVIL APPEAL NO. 2919 OF 2015
[ARISING OUT OF SLP (CIVIL) NO.3804 OF 2011]

CIVIL APPEAL NO. 2920 OF 2015
[ARISING OUT OF SLP (CIVIL) NO.5381 OF 2011]

CIVIL APPEAL NO. 2921 OF 2015
[ARISING OUT OF SLP (CIVIL) NO.5383 OF 2011]

CIVIL APPEAL NO. 2922 OF 2015
[ARISING OUT OF SLP (CIVIL) NO.5530 OF 2011]

CIVIL APPEAL NO. 2923 OF 2015
[ARISING OUT OF SLP (CIVIL) NO.19945 OF 2012]

J U D G M E N T

R.F.Nariman, J.

1. Leave granted in the special leave petitions.

2. The present appeals relate to a common judgment dated 24th September, 2007 passed by the High Court of Uttarakhand, Nainital in two income tax appeals, and a judgment of the Punjab and Haryana High Court dated 29th January, 2010 in Pine Grove International Charitable Trust v. Union of India – (2010) 327 ITR 273 . Various other appeals (excepting Civil Appeal No.8962 of 2010) are filed by the Union of India/ Central Board of Direct Taxes in cases where the aforesaid judgment in Pine Grove has been followed.

3. The facts necessary to understand the controversy in the two income tax appeals before the Uttarakhand High Court, Nainital, may be gleaned from the facts of one of them, namely, the Queen's Educational Society case. The appellant filed its return for assessment years 2000-2001 and 2001-2002 showing a net surplus of Rs.6,58,862/- and Rs.7,82,632/- respectively. Since the appellant was established with the sole

object of imparting education, it claimed exemption under Section 10(23C) (iiiad) of the Income Tax Act, 1961. The Assessing Officer *vide* its order dated 20th February, 2003 rejected the exemption claimed by the appellant. The CIT (Appeals) by its order dated 28th March, 2003 allowed the appellant's appeal, and the ITAT, Delhi, by its judgment dated 7th July, 2006 passed an order dismissing the appeal preferred by the revenue. In a reference to the High Court under Section 260A of the Income Tax Act, the High Court *vide* the impugned judgment set aside the judgment of the ITAT and affirmed the order of the Assessing Officer.

4. These appeals from the Uttarakhand High Court, Nainital, concern themselves with the provision of Section 10(23C) (iiiad) of the Act:

> "Section 10- **Incomes not included in total income**.—In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—
>
> (23-C) any income received by any person on behalf of—
>
> (*iii-ad*) 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"

5. It will be noticed that the Section has three requirements – (a) the educational institution must exist solely for educational purposes (b) it should not be for purposes of profit and (c) the aggregate annual receipts of such institution should not exceed the amount or annual receipts as may be prescribed. Such prescription is to be found in Rule 2CA being an amount of Rs.1 crore.

6. The said Section was inserted by Finance Act No.2 of 1998 with effect from 1st April, 1999. Prior thereto, the Income Tax Act had a corresponding Section, namely, Section 10(22) which was as follows:-

> "Section 10- **Incomes not included in total income**.—In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—
>
> (22) any income of a university or other educational institution, existing solely for educational purposes and not for purposes of profit"

7. We have heard learned counsel for the assessees as well as learned counsel for the revenue. The assessees argue that the impugned judgment is contrary to the law laid down by at least three Supreme Court judgments. Further, the wrong test has been adopted and followed, which is a test laid down by the Assessing Officer and not by any Supreme Court judgment – namely, that whenever a profit/surplus is made by an educational institution, it ceases to exist solely for educational purposes and becomes a profit making enterprise. In support of the Punjab and Haryana High Court judgment under appeal, counsel for the assessees argued that since the sole basis for not granting them exemption for the assessment years under question was the following of the Uttarakhand High Court judgment, if the said judgment is found to be incorrect, they are bound to succeed. For that reason, the revenue's appeal against the Punjab and Haryana High Court judgment should be dismissed. Counsel for the revenue, on the other hand, attempted to support the Uttarakhand High Court judgment by stating that the Section does not contemplate the making of large profits. If an educational institution in fact makes large

profits then even though it may plough such profits back into the purchase of assets for education, yet such institution cannot be said to be existing solely for educational purposes. It would then become an institution which would really be for profit.

8. In ***CIT v. Surat Art Silk Cloth Manufacturers' Assn.***, (1980) 121 ITR 1, this Court while construing the definition of "charitable purpose" in Section 2(15) of the Income Tax Act held:

> "17. The next question that arises is as to what is the meaning of the expression "activity for profit". Every trust or institution must have a purpose for which it is established and every purpose must for its accomplishment involve the carrying on of an activity. The activity must, however, be for profit in order to attract the exclusionary clause and the question therefore is when can an activity be said to be one *for* profit? The answer to the question obviously depends on the correct connotation of the preposition "for". This preposition has many shades of meaning but when used with the active participle of a verb it means "for the purpose of" and connotes the end with reference to which something is done. It is not therefore enough that as a matter of fact an activity results in profit but it must be carried on with the object of earning profit. Profit-making must be the end to which the activity must be directed or in other words, the predominant object of the activity must be making a profit. Where an activity is not pervaded by profit motive but is carried on primarily for serving the charitable purpose, it would not be correct to describe it as an activity for profit. But

where, on the other hand, an activity is carried on with the predominant object of earning profit, it would be an activity for profit, though it may be carried on in advancement of the charitable purpose of the trust or institution. Where an activity is carried on as a matter of advancement of the charitable purpose or for the purpose of carrying out the charitable purpose, it would not be incorrect to say as a matter of plain English grammar that the charitable purpose involves the carrying on of such activity, but the predominant object of such activity must be to subserve the charitable purpose and not to earn profit. The charitable purpose should not be submerged by the profit making motive; the latter should not masquerade under the guise of the former. The purpose of the trust, as pointed out by one of us (Pathak,J.) in *Dharmadeepti* v. *CIT* [(1978) 3 SCC 499 : 1978 SCC (Tax) 193] must be '"essentially charitable in nature" and it must not be a cover for carrying on an activity which has profit making as its predominant object. This interpretation of the exclusionary clause in Section 2 clause (15) derives considerable support from the speech made by the Finance Minister while introducing that provision. The Finance Minister explained the reason for introducing this exclusionary clause in the following words:

"The definition of 'charitable purpose' in that clause is at present so widely worded that it can be taken advantage of even by commercial concerns which, while ostensibly serving a public purpose, get fully paid for the benefits provided by them namely, the newspaper industry which while running its concern on commercial lines can claim that by circulating newspapers it was improving the general knowledge of the public. In order to prevent the misuse of this definition in such cases, the Select Committee felt that the words 'not involving the

carrying on of any activity for profit' should be added to the definition."

It is obvious that the exclusionary clause was added with a view to overcoming the decision of the Privy Council in the *Tribune case* [AIR 1939 PC 208 : In Re the Trustees of the Tribune, (1939) 7 ITR 415] where it was held that the object of supplying the community with an organ of educated public opinion by publication of a newspaper was an object of general public utility and hence charitable in character, even though the activity of publication of the newspaper was carried on commercial lines with the object of earning profit. The publication of the newspaper was an activity engaged in by the trust for the purpose of carrying out its charitable purpose and on the facts it was clearly an activity which had profit making as its predominant object, but even so it was held by the Judicial Committee that since the purpose served was an object of general public utility, it was a charitable purpose. It is clear from the speech of the Finance Minister that it was with a view to setting at naught this decision that the exclusionary clause was added in the definition of "charitable purpose". The test which has, therefore, now to be applied is whether the predominant object of the activity involved in carrying out the object of general public utility is to subserve the charitable purpose or to earn profit. Where profit making is the predominant object of the activity, the purpose, though an object of general public utility, would cease to be a charitable purpose. But where the predominant object of the activity is to carry out the charitable purpose and not to earn profit, it would not lose its character of a charitable purpose merely because some profit arises from the activity. The exclusionary clause does not require that the activity must be carried on in such a manner that it does not result in any profit. It would indeed be difficult for persons in charge of a trust or institution

to so carry on the activity that the expenditure balances the income and there is no resulting profit. That would not only be difficult of practical realisation but would also reflect unsound principle of management. We, therefore, agree with Beg, J., when he said in *Sole Trustee, Loka Shikshana Trust case* [(1976) 1 SCC 254 : 1976 SCC (Tax) 14 : (1975) 101 ITR 234] that "if the profits must necessarily feed a charitable purpose under the terms of the trust, the mere fact that the activities of the trust yield profit will not alter the charitable character of the trust. The test now is, more clearly than in the past, the genuineness of the purpose tested by the obligation created to spend the money exclusively or essentially on charity". The learned Judge also added that the restrictive condition "that the purpose should not involve the carrying on of any activity for profit would be satisfied if profit making is not the real object" (emphasis supplied). We wholly endorse these observations.

The application of this test may be illustrated by taking a simple example. Suppose the Gandhi Peace Foundation which has been established for propagation of Gandhian thought and philosophy, which would admittedly be an object of general public utility, undertakes publication of a monthly journal for the purpose of carrying out this charitable object and charges a small price which is more than the cost of the publication and leaves a little profit, would it deprive the Gandhi Peace Foundation of its charitable character? The pricing of the monthly journal would undoubtedly be made in such a manner that it leaves some profit for the Gandhi Peace Foundation, as, indeed, would be done by any prudent and wise management, but that cannot have the effect of polluting the charitable character of the purpose, because the predominant object of the activity of publication of the monthly journal would be to carry out the charitable purpose by

propagating Gandhian thought and philosophy and not to make profit or in other words, profit making would not be the driving force behind this activity. But it is possible that in a given case the degree or extent of profit making may be of such a nature as to reasonably lead to the inference that the real object of the activity is profit making and not serving the charitable purpose. If, for example, in the illustration given by us, it is found that the publication of the monthly journal is carried on wholly on commercial lines and the pricing of the monthly journal is made on the same basis on which it would be made by a commercial organisation leaving a large margin of profit, it might be difficult to resist the inference that the activity of publication of the journal is carried on for profit and the purpose is non-charitable. We may take by way of illustration another example given by Krishna Iyer, J., in the *Indian Chamber of Commerce case* [(1976) 1 SCC 324 : 1976 SCC (Tax) 41 : (1975) 101 ITR 796] where a blood bank collects blood on payment and supplies blood for a higher price on commercial basis. Undoubtedly, in such a case, the blood bank would be serving an object of general public utility but since it advances the charitable object by sale of blood as an activity carried on with the object of making profit, it would be difficult to call its purpose charitable. Ordinarily there should be no difficulty in determining whether the predominant object of an activity is advancement of a charitable purpose or profit making. But cases are bound to arise in practice which may be on the borderline and in such cases the solution of the problem whether the purpose is charitable or not may involve much refinement and present real difficulty.

There is, however, one comment which is necessary to be made whilst we are on this point and that arises out of certain observations made by

this Court in *Sole Trustee, Loka Shikshana Trust case* [(1976) 1 SCC 254 : 1976 SCC (Tax) 14 : (1975) 101 ITR 234] as well as *Indian Chamber of Commerce case* [(1976) 1 SCC 324 : 1976 SCC (Tax) 41 : (1975) 101 ITR 796] . It was said by Khanna, J. in *Sole Trustee, Loka Shikshana Trust case* [(1976) 1 SCC 254 : 1976 SCC (Tax) 14 : (1975) 101 ITR 234] :

"[I]f the activity of a trust consists of carrying on a business and there are no restrictions on its making profit, the court would be well justified in assuming in the absence of some indication to the contrary that the object of the trust involves the carrying on of an activity for profit."

And to the same effect, observed Krishna Iyer, J. in the *Indian Chamber of Commerce case* [(1976) 1 SCC 324 : 1976 SCC (Tax) 41 : (1975) 101 ITR 796] when he said:

"An undertaking by a business organisation is ordinarily assumed to be for profit unless expressly or by necessary implication or by eloquent surrounding circumstances the making of profit stands loudly negatived .... A pragmatic condition, written or unwritten, proved by a prescription of profits or by long years, of invariable practice or spelt from some strong surrounding circumstances indicative of anti-profit motivation — such a condition will qualify for charitable purpose."

Now we entirely agree with the learned Judges who decided these two cases that activity involved in carrying out the charitable purpose must not be motivated by a profit objective but it must be undertaken for the purpose of advancement or carrying out of the charitable purpose. But we find it difficult to accept their thesis that whenever an activity is carried on which yields profit, the inference must necessarily be drawn, in the

absence of some indication to the contrary, that the activity is *for* profit and the charitable purpose involves the carrying on of an activity for profit. We do not think the Court would be justified in drawing any such inference merely because the activity results in profit. It is in our opinion not at all necessary that there must be a provision in the constitution of the trust or institution that the activity shall be carried on no profit no loss basis or that profit shall be proscribed. Even if there is no such express provision, the nature of the charitable purpose, the manner in which the activity for advancing the charitable purpose is being carried on and the surrounding circumstances may clearly indicate that the activity is not propelled by a dominant profit motive. What is necessary to be considered is whether having regard to all the facts and circumstances of the case, the dominant object of the activity is profit making or carrying out a charitable purpose. If it is the former, the purpose would not be a charitable purpose, but, if it is the latter, the charitable character of the purpose would not be lost.

9. Coming closer to the section at hand, in ***Aditanar Educational Institution*** *v.* ***Additional Commissioner of Income Tax,*** (1997) 224 ITR 310, this Court while construing the predecessor Section, namely, Section 10(22) of the Income Tax act, held:

"The High Court has made an observation that any income which has a direct relation or incidental to the running of the institution as such would qualify for exemption. We may state that the language of

Section 10(22) of the Act is plain and clear and the availability of the exemption should be evaluated each year to find out whether the institution existed during the relevant year solely for educational purposes and not for the purposes of profit. After meeting the expenditure, if any surplus results incidentally from the activity lawfully carried on by the educational institution, it will not cease to be one existing solely for educational purposes 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/difference between the corpus, the objects and the powers of the concerned entity."

10. In ***American Hotel & Lodging Assn. Educational Institute*** *v.* ***CBDT*****,** (2008) 301 ITR 86, this Court dealt with Section 10(23C)(vi) as follows:

"29. In *CIT* v. *Surat Art Silk Cloth Manufacturers' Assn.* [(1980) 2 SCC 31 : 1980 SCC (Tax) 170 : (1980) 121 ITR 1] it has been held by this 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.

30. 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 (see judgment of this Court in *Oxford University Press* [(2001) 3 SCC 359 : (2001) 247 ITR 658]). Therefore, the character of the recipient of income must 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 be one existing *solely* for educational purposes. *In other words, existence of surplus from the activity will not mean absence of educational purpose* (see judgment of this Court in *Aditanar Educational Institution*v. *CIT* [(1997) 3 SCC 346 : (1997) 224 ITR 310]). 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.

32. We shall now consider the effect of insertion of provisos to Section 10(23-C)(*vi*) vide the Finance (No. 2) Act, 1998. Section 10(23-C)(*vi*) is analogous to Section 10(22). To that extent, the judgments of this Court as applicable to Section 10(22) would equally apply to Section 10(23-C)(*vi*). The problem arises with the insertion of the provisos to Section 10(23-C)(*vi*). With the insertion of the provisos to Section 10(23-C)(*vi*) the applicant who seeks approval has not only to show that it is an institution existing solely for educational purposes [which was also the requirement under Section 10(22)] but it has now to obtain initial approval from the PA, in terms of Section 10(23-C)(*vi*) by making an

application in the standardised form as mentioned in the first proviso to that section. That condition of obtaining approval from the PA came to be inserted because Section 10(22) was abused by some educational institutions/universities. This proviso was inserted along with other provisos because there was no monitoring mechanism to check abuse of exemption provision. With the insertion of the first proviso, the PA is required to vet the application. This vetting process is stipulated by the second proviso. Under the twelfth proviso, the PA is required to examine cases where an applicant does not apply its income during the year of receipt and accumulates it but makes payment therefrom to any trust or institution registered under Section 12-AA or to any fund or trust or institution or university or other educational institution and to that extent the proviso states that such payment shall not be treated as application of income to the objects for which such trust or fund or educational institution is established. The idea underlying the twelfth proviso is to provide guidance to the PA as to the meaning of the words “application of income to the objects for which the institution is established”. Therefore, the twelfth proviso is the matter of detail. The most relevant proviso for deciding this appeal is the thirteenth proviso. Under that proviso, the circumstances are given under which the PA is empowered to withdraw the approval earlier granted. Under that proviso, if the PA is satisfied that the trust, fund, university or other educational institution, etc. has not applied its income in accordance with the third proviso or if it finds that such institution, trust or fund, etc. has not invested/deposited its funds in accordance with the third proviso or that the activities of such fund or institution or trust, etc. are not genuine or that its activities are not being carried out in accordance with the conditions subject to which approval is granted then the PA is empowered to withdraw the

approval earlier granted after complying with the procedure mentioned therein.

33. Having analysed the provisos to Section 10(23-C)(*vi*) one finds that there is a difference between stipulation of conditions and compliance therewith. The threshold conditions are actual existence of an educational institution and approval of the prescribed authority for which every applicant has to move an application in the standardised form in terms of the first proviso. It is only if the prerequisite condition of actual existence of the educational institution is fulfilled that the question of compliance with requirements in the provisos would arise. We find merit in the contention advanced on behalf of the appellant that the third proviso contains monitoring conditions/requirements like application, accumulation, deployment of income in specified assets whose compliance depends on events that have not taken place on the date of the application for initial approval.

34. To make the section with the proviso workable we are of the view that the monitoring conditions in the third proviso like application/utilisation of income, pattern of investments to be made, etc. could be stipulated as conditions by the PA subject to which approval could be granted."

11. Thus, the law common to Section 10(23C) (iiiad) and (vi) may be summed up as follows:

(1) Where 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.

(2) The predominant object test must be applied – the purpose of education should not be submerged by a profit making motive.

(3) 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.

(4) If after meeting expenditure, a surplus arises incidentally from the activity carried on by the educational institution, it will not be cease to be one existing solely for educational purposes.

(5) 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.

12. The Uttarakhand High Court in the impugned judgment dated 24th September, 2007 quoted the ITAT order in paragraph 7 as follows:

> "The ITAT while granting exemption under Section 10(23C) (iiiad) recorded the following reasons:
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> "During the years relevant for asstt. Year 2000-01 and 2001-02, the excess of income over expenditure stood at Rs.6,58,862/- and Rs.7,82,632/- respectively. It was also noticed that the appellant society had made investment in fixed assets including building at Rs.9,52,010/- in F.Y. 1999-2000 and Rs.8,47,742/- in FY 2000-01 relevant for Asstt. Years 2000-01 and 2001-02 respectively. Thus, if the amount of investment into fixed assets such as building, furniture and fixture etc. were also kept in view, there was hardly any surplus left….. The assessee society is undoubtedly engaged in imparting education and has to maintain a teaching and non teaching staff and has to pay for their salaries and other incidental expenses. It, therefore, becomes necessary to charge certain fee from the students for meeting all these expenses. The charging of fee is incidental to the prominent objective of the trust i.e. imparting education. The trust was initially running the school in a rented building and the surplus, i.e. the excess of the receipts over expenditure.
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> In the year under appeal (and in the earlier appeals) has enabled the appellant to acquire its own property, acquire computers, library books, sports equipments etc. for the benefit of the students. And more importantly the members of the society have not utilized any part of the surplus for their own benefit. The AO wrongly interpreted the resultant

surplus as the main objective of the assessee trust. As held above, profit is only incidental to the main object of spreading education. If there is no surplus out of the difference between receipts and outgoings, the trust will not be able to achieve the objectives. Any education institution cannot be run in rented premises for all the times and without necessary equipment and without paying to the staff engaged in imparting education. The assessee is not getting any financial aid/assistance from the Government or other philanthropic agency and, therefore, to achieve the objective, it has to raise its own funds. But such surplus would not come within the ambit of denying exemption u/s 10(23C) (iiiad) of the Act."

13. Having set out the ITAT order, the Uttarakhand High Court held:

"Thus, in view of the established fact relating to earned profit, we do not agree with the reasoning given by the ITAT for granting exemption."

14. Having said this, the impugned judgment goes on to quote ***Aditanar Educational Institution v. CIT***. as follows:-

"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 difference between the corpus, the objects and powers of the concerned entity.

If one looks at the object clause, there are other noble and pious objects but assessee society has done nothing to achieve the other objects except pursuing main object of providing education and earning profit. Further, with profit earned the society has strengthened or enhanced its capacity to earn more rather than to fulfill other noble objects for the cause of poor and needy people or advancement of religious purpose.

Therefore, the law laid down by the Apex Court has rightly been applied and exemption has also rightly been refused by the Assessing Officer in the facts and circumstances of the case."

15. It is clear that the High Court did not apply its mind independently. What has been copied is one paragraph from the Supreme Court judgment in ***Aditanar*** followed by a paragraph of faulty reasoning by the Assessing Officer and the said faulty reasoning of the Assessing Officer has been wrongly said to be the law laid down by the Apex Court.

16. Further, the Supreme Court Judgment in ***Municipal Corpn. of Delhi*** *v.* ***Children Book Trust*** and ***Safdarjung Enclave Educational Society,*** (1992) 3 SCC 390 has then been followed. The aforesaid judgment dealt with a property tax provision, namely, Section 115 (4) of the Delhi Municipal

Corporation Act, 1957. Three questions were raised in the said judgment as follows:-

> "56. In the present case, the questions which arise for our determination are:
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> (*i*) Whether the society or body is occupying and using the land and building for a charitable purpose within the meaning of sub-section (4)?
>
> (*ii*) What is the meaning of the expression "supported wholly or in part by voluntary contribution"?
>
> (*iii*) Whether any trade or business is carried on in the premises within the meaning of sub-section (5)?"

17. In answering question one, the Court held that School Education would only come within an exemption if it involved public benefit. Having so held, the Court stated:

> "78. The rulings arising out of Income Tax Act may not be of great help because in the Income Tax Act "charitable purpose" includes the relief of the poor, education, medical relief and the advancement of any other object of general public utility. The advancement of any other object of general public utility is not found under the Delhi Municipal Corporation Act. In other words, the definition is narrower in scope. This is our answer to question No. 1."

18. Secondly, the extracted portion from the said judgment in the judgment of the Uttarakhand High Court concerned itself

with question two, namely, whether the educational society is supported wholly or in part by voluntary contributions. It is part of paragraph 80 of the said judgment. If the sentences after the quoted portion are also set out, it becomes clear that the passage relied upon by the High Court has absolutely nothing to do with the present case. The entirety of the passage is now set out hereinbelow:

> "82. …In other words, what we want to stress is, where a society or body is making systematic profit, even though that profit is utilised only for charitable purposes, yet it cannot be said that it could claim exemption. If, merely qualitative test is applied to societies, even schools which are run on commercial basis making profits would go out of the purview of taxation and could demand exemption. Thus, the test, according to us, must be whether the society could survive without receiving voluntary contributions, even though it may have some income by the activities of the society. The word "part" mean an appreciable amount and not an insignificant one. The "part" in other words, must be substantial part. What is substantial would depend upon the facts and circumstances of each case."

19. It is clear, therefore, that the Uttarakhand High Court has erred by quoting a non existent passage from an applicable judgment, namely, Aditanar and quoting a portion of a property tax judgment which expressly stated that rulings arising out of

the Income Tax Act would not be applicable. Quite apart from this, it also went on to further quote from a portion of the said property tax judgment which was rendered in the context of whether an educational society is supported wholly or in part by voluntary contributions, something which is completely foreign to Section 10(23C) (iiiad). The final conclusion that if a surplus is made by an educational society and ploughed back to construct its own premises would fall foul of Section 10(23C) is to ignore the language of the Section and to ignore the tests laid down in the ***Surat Art Silk Cloth*** case, Aditanar case and the American Hotel and Lodging case. It is clear that when a surplus is ploughed back for educational purposes, the educational institution exists solely for educational purposes and not for purposes of profit. In fact, in ***S.RM.M.CT.M. Tiruppani Trust v. Commissioner of Income Tax***, (1998) 2 SCC 584, this Court in the context of benefit claimed under Section 11 of the Act held:

> "9. In the present case, the assessee is not claiming any benefit under Section 11(2) as it cannot; because in respect of this assessment year, the assessee has not complied with the conditions laid down in Section 11(2). The assessee, however,

> is entitled to claim the benefit of Section 11(1)(*a*). In the present case, the assessee has applied Rs 8 lakhs for charitable purposes in India by purchasing a building which is to be utilised as a hospital. This income, therefore, is entitled to an exemption under Section 11(1). In addition, under Section 11(1)(*a*), the assessee can accumulate 25% of its total income pertaining to the relevant assessment year and claim exemption in respect thereof. Section 11(1)(*a*) does not require investment of this limited accumulation in government securities. The balance income of Rs 1,64,210.03 constitutes less than 25% of the income for Assessment Year 1970-71. Therefore, the assessee is entitled to accumulate this income and claim exemption from income tax under Section 11(1)(*a*)."

We set aside the judgment of the Uttarakhand High Court dated 24th September, 2007. The reasoning of the ITAT (set aside by the High Court) is more in consonance with the law laid down by this Court, and we approve its decision.

20. Revenue's appeals from the Punjab and Haryana High Court concern themselves with Sections 10(23C) (vi). A large number of writ petitions were heard in Civil Writ Petition No. 6031 of 2009 and disposed of on 29th January, 2010. By various impugned orders passed, the Chief, CIT, Chandigarh withdrew exemptions granted under Section 10(23C) (vi) of the Income Tax Act read with Rule 2CA of Income Tax Rules,

1961, for various assessment years. The operative part of the order passed by the Chief, CIT in these cases is the same and reads as follows:

> "4. I have considered the submissions of the assessee. The decisions quoted in support of its contention are not relevant and are distinguishable on facts as well as issues. It is clear that the ratio of the decision of Hon'ble Uttarakhand High Court is squarely applicable in this case.
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> 5. The Hon'ble Supreme Court has held, in the case of *Aditanar Educational Institution etc.* v. *Addl. Commissioner of Income Tax* [224 ITR 310 (SC)], that in the case of an educational institution, after meeting the expenditure, if any surplus results incidentally, then the institution will not cease to be one existing solely for educational purposes.
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> 6. The crucial condition is that surplus should result only incidentally and should not be aimed for. If substantial profits are earned in one year if (it)? would be duty of the institution to lower its fees for the subsequent year so that such profits are not intentionally generated. If, however, profits continue year after year than it cannot be said that the surplus is arising incidentally.
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> 7. In the present ease, the profits are substantial and are arising year alter year and therefore, the decision of the Apex Court in the case of *Aditanar Education Institution* v. *Addl. Commissioner of Income Tax* as well as the decision of the Hon'ble Uttrakhand High Court is applicable.
>
> 8. Exemption u/s 10(23C)(vi) is not available to the assessee under the law in view of the above facts and circumstances and therefore, exemption already granted *vide* order dated 4th June, 2007 is hereby withdrawn.

9. The assessee is at liberty to reduce the fees being charged and price of its services and apply afresh, in which case the application will be duly considered on merits."

21. It is these orders that were set aside by the judgment of the Punjab and Haryana High Court impugned by the Revenue before us.

22. Section 10(23C)(vi) read with the 3rd and 13th provisos thereto and Section 11(5) of the Income Tax Act are as follows:-

"Section 10- **Incomes not included in total income**.—In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—

(23-C) any income received by any person on behalf of—

(*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 (iii-ab) or sub-clause (iii-ad) and which may be approved by the prescribed authority

Provided also that the fund or trust or institution [or any university or other educational institution or any hospital or other medical institution] referred to in sub-clause (*iv*) or sub-clause (*v*)[or sub-clause (*vi*) or sub-clause (*vi-a*)]—[(*a*) *applies its income*, *or accumulates it for application*, *wholly and exclusively to the objects for which it is established*

and in a case where more than fifteen per cent of its income is accumulated on or after the 1st day of April, 2002, the period of the accumulation of the amount exceeding fifteen per cent of its income shall in no case exceed five years; *and*;].

[(*b*) does not invest or deposit its funds, other than —

(*i*) any assets held by the fund, trust or institution [or any university or other educational institution or any hospital or other medical institution] where such assets form part of the corpus of the fund, trust or institution [or any university or other educational institution or any hospital or other medical institution] as on the 1st day of June, 1973;

[(*i-a*) any asset, being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution where such assets form part of the corpus of any university or other educational institution or any hospital or other medical institution as on the 1st day of June, 1998;]

(*ii*) any assets (being debentures issued by, or on behalf of, any company or corporation), acquired by the fund, trust or institution [or any university or other educational institution or any hospital or other medical institution] before the 1st day of March, 1983;

(*iii*) any accretion to the shares, forming part of the corpus mentioned in sub-clause (*i*)[and sub-clause (*i-a*)], by way of bonus shares allotted to the fund, trust or institution[or any university or other educational institution or any hospital or other medical institution];

(*iv*) voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the Official Gazette, specify,

for any period during the previous year otherwise than in any one or more of the forms or modes specified in sub-section (5) of Section 11:

Provided also *that where the fund or institution referred to in sub-clause* (*iv*) *or trust or institution referred to in sub-clause* (*v*) *is notified by the Central Government or any university or other educational institution referred to in sub-clause* (*vi*) *or any hospital or other medical institution referred to in sub-clause* (*vi-a*), *is approved by the prescribed authority and subsequently that Government or the prescribed authority is satisfied that—*

(*i*) *such fund or institution or trust or any university or other educational institution or any hospital or other medical institution has not*,—

(*A*) *applied its income in accordance with the provisions contained in clause* (*a*) *of the third proviso*; *or*

(*B*) *invested or deposited its funds in accordance with the provisions contained in clause*(*b*) *of the third proviso*; *or*

(*ii*) *the activities of such fund or institution or trust or any university or other educational institution or any hospital or other medical institution*,—

(*A*) *are not genuine*; *or*

(*B*) *are not being carried out in accordance with all or any of the conditions subject to which it was notified or approved*,

it may, at any time after giving a reasonable opportunity of showing cause against the proposed action to the concerned fund or institution or trust or any university or other educational institution or any hospital or other medical institution, rescind the notification or, by order, withdraw the approval, as the case may be, and forward a copy of the order

rescinding the notification or withdrawing the approval to such fund or institution or trust or any university or other educational institution or any hospital or other medical institution and to the Assessing Officer;]

Section 11. Income from property held for charitable or religious purposes.—

(5) The forms and modes of investing or depositing the money referred to in clause (*b*) of sub-section (2) shall be the following, namely:—

(*i*) investment in savings certificates as defined in clause (*c*) of Section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government;

(*ii*) deposit in any account with the Post Office Savings Bank;

(*iii*) deposit in any account with a scheduled bank or a cooperative society engaged in carrying on the business of banking (including a cooperative land mortgage bank or a cooperative land development bank).

Explanation.—In this clause, "scheduled bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

(*iv*) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(*v*) investment in any security for money created and issued by the Central Government or a State Government;

(*vi*) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;

(*vii*) investment or deposit in any public sector company:

[**Provided** that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company,—

(*A*) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;

(*B*) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;].

(*viii*) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and [which is eligible for deduction under clause (*viii*) of sub-section (1) of Section 36];

(*ix*) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of

providing long-term finance for construction or purchase of houses in India for residential purposes and[which is eligible for deduction under clause (*viii*) of sub-section (1) of Section 36];

[(ix-a) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation.—For the purposes of this clause,—

(*a*) "long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;

(*b*) "public company" shall have the meaning assigned to it in Section 3 of the Companies Act, 1956;

(*c*) "urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport;].

(*x*) investment in immovable property.

Explanation.—"Immovable property" does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;

(*xi*) deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 (18 of 1964);

(*xii*) any other form or mode of investment or deposit as may be prescribed."

23. The Punjab and Haryana High Court, by the impugned judgment dated 29th January, 2010 expressed its dissatisfaction with the view taken by the Uttarakhand High Court in the case of Queen's Educational Society as follows:

> "8.8 We have not been able to persuade ourselves to accept the view expressed by the Division Bench of the Uttrakhand High Court in the case of *Queens Educational Society* (supra). There are variety of reasons to support our opinion. Firstly, the scope of the third proviso was not under consideration, inasmuch as, the case before the Uttrakhand High Court pertained to Section 10(23C)(iiiad) of the Act. The third proviso to Section 10(23C)(vi) is not applicable to the cases falling within the purview of Section 10(23C)(iiiad). Secondly, the judgment rendered by the Uttarkhand High Court runs contrary to the provisions of Section 10(23C)(vi) of the Act including the provisos thereunder. Section 10(23C)(vi) of the Act is equivalent to the provisions of Section 10(22) existing earlier, which were introduced with effect from 1st April, 1999 and it ignores the speech of the Finance Minister made before the introduction of the said provisions, namely. Section 10(23C) of the Act [See observations in *American Hotel and Lodging Association Educational Institute's case* (supra)]. Thirdly, the Uttrakhand High Court has not appreciated correctly the ratio of the judgment rendered by Hon'ble the Supreme Court in the case of *Aditanar Educational Institution*(supra) and while applying the said judgment including the judgment which had been rendered by Hon'ble the Supreme Court in the case of *Children Book Trust* (supra), it lost sight of the amendment which had been carried out with effect from 1st April, 1999 leading to the

introduction of the provisions of Section 10(23C) of the Act. Lastly, that view is not consistent with the law laid down by Hon'ble the Supreme Court in *American Hotel and Lodging Association Educational Institute* (surpa)."

It then summed up its conclusions as follows:

"8.13 From the aforesaid discussion, the following principles of law can be summed up:—

(1) It is obligatory on the part of the Chief Commissioner of Income Tax or the Director, which are the prescribed authorities, to comply with proviso thirteen (un-numbered). Accordingly, it has to be ascertained whether the educational institution has been applying its profit wholly and exclusively to the object for which the institution is established. Merely because an institution has earned profit would not be deciding factor to conclude that the educational institution exists for profit.

(2) The provisions of Section 10(23C)(vi) of the Act are analogous to the erstwhile Section 10(22) of the Act, as has been laid down by Hon'ble the Supreme Court in the case of *American Hotel and Lodging Association* (supra). To decide the entitlement of an institution for exemption under Section 10(23C)(vi) of the Act, the test of predominant object of the activity has to be applied by posing the question whether it exists solely for education and not to earn profit [See 5-Judges Constitution Bench judgment in the case of *Surat Art Silk Cloth Manufacturers Association* (supra)]. It has to be borne in mind that merely because profits have resulted from the activity of imparting education would not result in change of character of the institution that it exists solely for educational purpose. A workable solution has been provided by Hon'ble the Supreme Court in

para 33 of its judgment in *American Hotel and Lodging Association's case* (supra). Thus, on an application made by an institution, the prescribed authority can grant approval subject to such terms and conditions as it may deems fit provided that they are not in conflict with the provisions of the Act. The parameters of earning profit beyond 15% and its investment wholly for educational purposes may be expressly stipulated as per the statutory requirement. Thereafter the Assessing Authority may ensure compliance of those conditions. The cases where exemption has been granted earlier and the assessments are complete with the finding that there is no contravention of the statutory provisions, need not be reopened. However, alter grant of approval if it comes to the notice of the prescribed authority that the conditions on which approval was given, have been violated or the circumstances mentioned in 13th proviso exists, then by following the procedure envisaged in 13th proviso, the prescribed authority can withdraw the approval.

(3) The capital expenditure wholly and exclusively to the objects of education is entitled to exemption and would not constitute part of the total income.

(4) The educational institutions, which are registered as a Society, would continue to retain their character as such and would be eligible to apply for exemption under Section 10(23C)(vi) of the Act. [See para 8.7 of the judgment-*Aditanar Educational Institution case* (supra)]

(5) Where more than 15% of income of an educational institution is accumulated on or after 1st April, 2002, the period of accumulation of the amount exceeding 15% is not permissible beyond five years, provided the excess income has been applied or accumulated for application wholly and exclusively for the purpose of education.

(6) The judgment of Uttrakhand High Court rendered in the case of *Queens Educational Society* (supra) and the connected matters, is not applicable to cases fall within the provision of Section 10(23C)(vi) of the Act. There are various reasons, which have been discussed in para 8.8 of the judgment, and the judgment of Allahabad High Court rendered in the case of *City Montessori School* (supra) lays down the correct law."

And finally held:

"8.15 As a sequel to the aforesaid discussion, these petitions are allowed and the impugned orders passed by the Chief Commissioner of Income Tax withdrawing the exemption granted under Section 10(23C)(iv) of the Act are hereby quashed. However, the revenue is at liberty to pass any fresh orders, if such a necessity is felt after taking into consideration the various propositions of law culled out by us in para 8.13 and various other paras.

8.16 The writ petitions stand disposed of in the above terms."

24. The view of the Punjab and Haryana High Court has been followed by the Delhi High Court in ***St. Lawrence Educational Society (Regd.) v. Commissioner of Income Tax & Anr.,*** (2011) 53 DTR (Del) 130. Also in ***Tolani Education Society v. Deputy Director of Income Tax (Exemption) & Ors.,*** (2013) 351 ITR 184, the Bombay High Court has expressed a view in line with the Punjab and Haryana High Court view, following the

judgments of this Court in the ***Surat Art Silk Manufacturers Association*** Case and ***Aditanar Educational Institution*** case as follows:

> "…..The fact that the Petitioner has a surplus of income over expenditure for the three years in question, cannot by any stretch of logical reasoning lead to the conclusion that the Petitioner does not exist solely for educational purposes or, as that Chief Commissioner held that the Petitioner exists for profit. The test to be applied is as to whether the predominant nature of the activity is educational. In the present case, the sole and dominant nature of the activity is education and the Petitioner exists solely for the purposes of imparting education. An incidental surplus which is generated, and which has resulted in additions to the fixed assets is utilized as the balance-sheet would indicate towards upgrading the facilities of the college including for the purchase of library books and the improvement of infrastructure. With the advancement of technology, no college or institution can afford to remain stagnant. The Income-tax Act 1961 does not condition the grant of an exemption under Section 10(23C) on the requirement that a college must maintain the status-quo, as it were, in regard to its knowledge based infrastructure. Nor for that matter is an educational institution prohibited from upgrading its infrastructure on educational facilities save on the pain of losing the benefit of the exemption under Section 10(23C). Imposing such a condition which is not contained in the statute would lead to a perversion of the basic purpose for which such exemptions have been granted to educational institutions. Knowledge in contemporary times is technology driven. Educational institutions have to

> modernise, upgrade and respond to the changing ethos of education.
>
> Education has to be responsive to a rapidly evolving society. The provisions of Section 10(23C) cannot be interpreted regressively to deny exemptions. So long as the institution exists solely for educational purposes and not for profit, the test is met."

25. We approve the judgments of the Punjab and Haryana, Delhi and Bombay High Courts. Since we have set aside the judgment of the Uttarakhand High Court and since the Chief CIT's orders cancelling exemption which were set aside by the Punjab and Haryana High Court were passed almost solely upon the law declared by the Uttarakhand High Court, it is clear that these orders cannot stand. Consequently, Revenue's appeals from the Punjab and Haryana High Court's judgment dated 29.1.2010 and the judgments following it are dismissed. We reiterate that the correct tests which have been culled out in the three Supreme Court judgments stated above, namely, Surat Art Silk Cloth, Aditanar, and American Hotel and Lodging, would all apply to determine whether an educational institution exists solely for educational purposes and not for purposes of profit. In addition, we hasten to add that the 13th proviso to

Section 10(23C) is of great importance in that assessing authorities must continuously monitor from assessment year to assessment year whether such institutions continue to apply their income and invest or deposit their funds in accordance with the law laid down. Further, it is of great importance that the activities of such institutions be looked at carefully. If they are not genuine, or are not being carried out in accordance with all or any of the conditions subject to which approval has been given, such approval and exemption must forthwith be withdrawn. All these cases are disposed of making it clear that revenue is at liberty to pass fresh orders if such necessity is felt after taking into consideration the various provisions of law contained in Section 10(23C) read with Section 11 of the Income Tax Act.

26. We now come to Civil Appeal No.8962 of 2010. *Vide* a judgment dated 29th January, 2010, the Punjab and Haryana High Court dismissed CWP No.7268 of 2009 in the following terms:

> "8. It is conceded position that the assessee-petitioner has filed the application on 23.9.2008 seeking exemption under Section 10(23C)(vi) in

respect of assessment year 2008-09, which could have been filed during the financial year 2007-08 i.e. on or before 31.3.2008. It is, thus, evident that the application by the assessee petitioner has been filed after the prescribed period and the Chief Commissioner of Income Tax has rightly rejected the same being not maintainable.

9. As a sequel to the above discussion, we find no ground to interfere with the impugned order passed by the Chief Commissioner of Income Tax. There is no merit in the instant petition warranting its admission. Accordingly, the writ petition fails and the same is dismissed."

27. These being the facts, we see no reason to interfere. This appeal shall stand dismissed with no order as to costs.

……..……..J.
(T.S. Thakur)

……..……..J.
(R.F. Nariman)

New Delhi,
March 16, 2015.