

# Analysing Relationship between Charity and Business in Income-tax Act



*State, though always fundamentally committed to incentivise the initiatives of volunteerism, is equally forthright to detest every attempt of adulteration of charity leading to the misuse of preferential tax regime. This adulteration and misuse has several manifestations and judiciary has very thoughtfully used a very appropriate term “business masquerading as charity” for such misadventures. More often than not, this is the result of the intermingling of the two; business and charity, to a proportion that there is stark blurring creating doubts in the minds of tax administrators. Read on to know more.....*



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## Background

Commonly understood, charity is antithesis of business. The motive of the two is the prime differentiator. Charity has existed for time immemorial and so would it exist for posterity. It has always been incentivised, across jurisdictions, by the state, in the form of tax exemptions and

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continuance of preferential tax treatment to charities, in future, is inevitable.

Such inevitability has conceptual moorings that guarantee its sustenance in all times to come. Simply put, state, being collective will of the people it represents, collects tax to spend it to promote common and collective welfare of the people. It is done, under an unwritten social contract. Visited minutely, this is what is done exactly by the charity. The only slight difference is that “volunteerism” replaces the “unwritten social contract”. Charity, in that limited sense, thus is an extended arm of the state, nay, which achieves the objective rather efficiently. Taxing charity by the state, therefore, is in a way taxing state itself and here is rooted the argument of its inevitability.

It has not been an easy task for the law makers to sift the chalk from the cheese and this is the reason is why it has toyed with several ideas both in the present act and in all previous acts. Even the judicial opinions on this separation have been confounded, more than often, depending on the prism of “welfare ideology” the concerned judge lean.

The purpose of the present article is to analyse the relationship between the business and charity, as it exists in the current law, and the impact that it produces on the exemption regime. It is admitted, upfront, that it cannot and would not be the final word on the subject.

### **Business and Charitable Purpose as defined in Section 2(15) read with proviso thereof of the Act:**

Section 2(15) defines charitable purposes. The section has a *proviso* and it states that advancement of any other object of general public utility shall not be charitable purpose, if it involves carrying on of any activity in the nature of trade, business or commerce or an activity of rendering any service in relation to any trade, commerce

or commerce for a cess or fee or for any other consideration, irrespective of the nature of use or application, or retention, of the income from such activity

Therefore, *proviso* to Section 2(15) does not apply to purposes other than the purpose of advancement of any other object of general public utility. Therefore, carrying on an activity in the nature of trade, commerce and business is not barred by such trust or institution. Such trusts to be given exemption u/s 11 of the Act, though, would be subject to the provisions of sub Section 4 and 4A of Section 11 of the Act.

Every purpose to be accomplished requires carrying on of some activities. It also requires doer which is either a trust or any other institution which undertakes activities to accomplish the purpose. Further, the purpose requires resources to be spent or used. Activities are also required to collect, manage and spend/use these resources.

The words “it involves”, in the *proviso*, refers to or qualifies “object” and not to “advancement”, is settled by the highest court in the context of similar use of language in the earlier provisions. The significance of this, as settled judicially in earlier context, was that the bar does not operate on the advancement but on the object; which meant that if the predominant purpose of the activities was accomplishment of the purpose of the trust and not for making profit, the bar would not operate. The mere fact that there is profit from the activities will not trigger the *proviso* in the old settled cases.<sup>1</sup>

In the new *proviso*, there is slight modification in the structure and language of the *proviso* and the changes and their effects have to be understood in the context of current language taking guide from what has been settled in the context of old but similar language.

Even in the modified *proviso*, as it stands now, the effect is that it is not the activities in the nature of trade, commerce or business or activity of rendering service in relation to trade commerce or business which are prohibited. What is prohibited is that predominant purpose of advancement of any other object of general public utility as reflected through or in the activities should not be in the nature of trade, commerce or business or rendering of any service in relation to trade, commerce or business, irrespective of the nature of use or application or retention of the income from such activity. In other

<sup>1</sup> *Additional Commissioner of Income Tax vs. Surat Art Silk Cloth Manufacturers Association (1979) 13 CTR 0378, (1979) 121 ITR 0001*

words if the dominant purpose of the activities is trade, commerce or business or rendering of service in relation to trade, commerce or business and not advancement of any other object of general public utility, the *proviso* gets triggered and advancement of any other object of general public utility shall not be charitable purpose<sup>2</sup>.

Carrying on of any activity in the nature of trade or commerce or an activity of rendering any service in relation to trade, commerce or business is not to be taken into account for each and every activity separately. Trade commerce or business or services in relation to trade commerce and business imply organised and bundled activities. Accordingly, sum effect of all activities, in determining charitable purpose, involving that purpose has to be tested on the touchstone of trade commerce or business. Alternative possible view could be that when purpose involves several subgroup of purposes or type of purposes, each subgroup or type has to be tested as to whether what is dominant purpose of each group or type.

Another important question in this regard to be answered is the effect of business held under trust or business carried on by the trust on the *proviso*. Preliminary question to this is whether such business is a purpose or an activity involving the purpose? Simple answer to this is that it is an activity involving the purpose. As predominant purpose of the activity of managing asset of the trust, which is business, is not trade or commerce or business or rendering of any service in relation to trade business or commerce but advancement of an object of general public utility (under the concept of income feeding the charity), such businesses are not hit by the *proviso*. Business held under trust or run by the trust may also not be hit by the *proviso* on another ground. It cannot be said in such cases that purpose of the trust, which is advancement of an object of general public utility,

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involves carrying on of the activity of business held under trust or run by the trust.

There can be a counter argument to the above hypothesis in view of the language of the *proviso* and that is dealt with below. The counter view may have genesis in the following arguments:

- (a) *Proviso* provides that nature of use or application or retention of the income from activities is of no consequences, which means concept of income feeding charity is given go by in the *proviso*
- (b) in the previous enactments, the concept was activity for profit which had different connotations unlike the present specific language which is clear and unambiguous and in the wake of the clear language, there is no scope for resorting to intendment
- (c) there is clear mandate that the moment there is carrying on of an activity in the nature of trade commerce or business for a fee, cess or any other consideration, it will render the object of general public utility non charitable *sans* exception carved out in the *proviso*
- (d) the mandate is more explicit, wide and clear in those cases where activity is of rendering service in relation to trade business or commerce for a fee, cess or any other consideration (here even there is no need of the nature of trade, commerce and business in the case of charitable purpose unlike in case before). In this case, there is no need of motive of profit making which is implicit in the case of trade, business and commerce. The difference between the two scenarios is vital and significant. In the first, requirement is that activity should be in the nature of trade, business or commerce (at the end of doer of the activity) and the status of the recipient of service is irrelevant and immaterial. In the latter, the status of the doer is irrelevant and immaterial but the status of recipient is vital
- (e) objective of the main *proviso* is to cast the widest possible net by providing specific exceptions to give relief in the cases intended.

The counter view above may appear to be attractive to adopt, but the most fundamental point it misses is that it unduly focusses on the advancement part and not the object part. What logically and

<sup>2</sup> *India Trade Promotion Organization vs. Director General of Income Tax (Exemptions) & Others* (2015) 274 CTR 0305 ( Delhi), (2015) 374 ITR 0333 (Delhi), *Institute of Chartered Accountants of India vs. Director General of Income Tax (Exemptions)* 347 ITR 99 (Del), *Institute of Chartered Accountants of India vs. DGIT (E) WP ( C ) 3147 decided on 4.7.2013*, *M/S G.S.I India vs. Director General of Income Tax ( Exemptions) and another 219 Taxman 205*, *Bureau of Indian Standards vs. Director General of Income Tax ( Exemptions) (2013) 212 Taxman 210 ( Del)*

  
**A question may arise whether the use of phrase “any activity in the nature of trade, commerce and business or any activity of rendering any service in relation to any trade, commerce or business” is redundant and superfluous.**  


reasonably has to be seen by focusing on the object part is that whether the purpose of the activity is accomplishment of advancement of any other object of general public utility or purpose is something else. The crux is that it is not the activity alone and by itself which have to be final determinant but the result and outcome of the activity on the advancement of the object of general public utility itself which has to be reckoned with so as to make them non-charitable. It is not the taint in the activity that matters in final analysis but taint on the purpose which would be relevant.

The *proviso* also lays down an exception to its application subject to fulfillment of conditions specified. Exception is couched in conditions and language which present quite interesting and curious interpretations. It is dealt with below.

A view has been propounded hereinbefore that the *proviso* does not get triggered by undertaking activities in the nature of trade business or commerce etc., if the purpose of such activities is not making profit but advancement of any other object of general public utility. Therefore, as per this view, to that extent, activities in the nature of trade, commerce and business etc., is excluded from the *proviso* then such activities should also not be reckoned for even for the purpose of exception. But on reading of the exception in the *proviso*, it appears that all activities in the nature of trade, commerce and business have to be taken into reckoning for eligibility of the exception. There appears to be apparent contradiction.

A question, then, may arise whether the use of phrase “any activity in the nature of trade, commerce and business or any activity of rendering any service in relation to any trade, commerce or business”<sup>3</sup> is redundant and superfluous.

To answer the above, one has to remind one-self that the section defines charitable purpose and for each purpose to be charitable it has to be tested separately on the definition. Each purpose may involve several activities, purpose of which may be trade, commerce and business while

purpose of the other activities may not be trade, commerce or business. The complexity arises with regard to the former and not the latter. The view is that to the extent the purpose of the former is also advancement of the said purpose, the *proviso* itself will not apply and one does not go to the saving part. In case the predominant purpose of both types of activities taken together is profit making and not advancement of the purpose in question, *proviso* will apply and the saving clause will come into operation. The illustration in case could be situation of multiple of charitable purposes. In such cases, charitable purposes involving activities predominantly in the nature of trade, commerce and business may be saved of being non-charitable if the conditions laid down in the *proviso* are met.

Saving clause has two limbs and each one is separately and collectively dealt with as under.

First of the two limbs stipulate that such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility. There could be two views on this limb. Let us take the example of advancement of object of promotion of trade and commerce. Activities undertaken on commercial lines to promote trade and commerce are nevertheless activities undertaken in the course of advancement of object of promotion of trade and commerce and would without doubt be covered by the first limb. But suppose the trust or institution is also engaged in business activity, whether held under trust or otherwise, income of which is used under trust obligation for the purpose of advancement of object of promotion and trade, whether or not such business activities qualify to be undertaken in the course of actual carrying out of advancement of promotion of trade and commerce for the purpose of the first limb? The issue has been dealt with in many courts' decisions and predominant view is that such business is carried on in the accomplishment of the purpose of the trust and therefore is also carried in the course of actual carrying out the purpose of the trust.

Before we go to the second limb, another small issue merits mention here. “Such activity” is used in the *proviso*. Does such activity refer to activity in the nature of trade, commerce or business or activity of rendering any service in relation to any trade, commerce and business or that activity which is involved in the advancement of any other object of general public utility? Simple answer to this seems that it refers to the latter.

<sup>3</sup> From Definition of 'Charitable purpose' u/s. 2(15) of the Income-tax Act, 1961

Second limb of what is saved from the operation of the *proviso* stipulates “the aggregate receipts from such activity or activities during the previous year do not exceed twenty percent of the total receipts, of the trust or institution undertaking such activity or activities during the previous year.” It is already stated in this article that the activities in the nature of trade, commerce and business etc., whose predominant purpose is advancement of object of general utility are out of the scope of the *proviso* totally. If that be the case, such activity or activities should also be excluded from “such activity”. It is the quantum of the balance of such activity or activities which need to not exceed twenty percent of the total receipts of the trust or institution. It needs to be stated here that the other viewpoint is quite plausible and cannot be ruled out. That view is that while determining whether or not charitable purpose is hit by the *proviso* all activities in the nature of trade, business and commerce or activity of rendering any service in relation to trade, business and commerce should be clubbed and then their percentage to the total receipts of the trust or institution should not exceed twenty percent to be not hit by the *proviso*. But the implicit assumption in this view is that it is not the purpose or object of general public utility that should not involve activity in the nature of trade, business and commerce but the bar is on the all activities in the nature of trade, business and commerce except when the percentage thereof is within twenty percent limit.

### Section 11 (4) and Section 11(4A)

After analysing the definition of charitable purpose, particularly the scope of the newly inserted *proviso*, we can move to examine Section 11(4A) and 11(4) of the Act, which deals with exemption of income of the trust or institution from the business held under trust or otherwise.

Before it is done, brief reference to Section 11(1) would be quite useful. Section 11(1) (a) states “subject to the provisions of Section 60 to 63, *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 percent of the income from such property, shall not be included in the total income of person in receipt of the income.”

Reading of Section 11(4) leaves no doubt that property held under trust includes business undertaking so held and income from such undertaking is allowed exemption from income subject to conditions prescribed therein. If one reads sub section 1 and sub section 4 of Section 11 together, it would be something like this. *Income derived from business undertaking held under trust wholly for charitable or religious purposes shall not be included in the total income of the person in receipt of the income.* Charitable purpose here means what is defined in Section 2(15) and it is here that the real complexity and ambiguity emerge. It is underlined that this ambiguity prevails in case of trust meant for and including charitable purposes of the residual nature, namely, advancement of any other object of general utility. Trusts having purposes other than advancement of any other object of general public utility are immune to this problem and would be eligible for exemption. We know that the *proviso* forbids charity status to advancement of any other object of general public utility if it involves the carrying on of any activity in the nature of trade, commerce or business or any activity of rendering any service in relation to any trade, commerce or business. Does business undertaking held under trust by a trust meant for advancement of any other object of general public utility mean and result that the purpose of such trust involves carrying on of activity in the nature of trade, commerce or business or any activity of rendering any service in relation to any trade commerce or business and thus hit by the *proviso* save as provided in the *proviso*? Several courts, in the context of old provisions have tried to answer this riddle by holding that *provisos* do not hit such cases. The matter of course is not free from doubt fully because some of the old decisions do speak in a different tangent and the issue is yet to be tested in the judiciary in the current avatar of the *proviso*. The ambiguity gets further compounded when trust with purpose of advancement of any other object of general public utility get involved into business undertaking as part of its *corpus*.

**Second limb of what is saved from the operation of the *proviso* stipulates “the aggregate receipts from such activity or activities during the previous year do not exceed twenty percent of the total receipts, of the trust or institution undertaking such activity or activities during the previous year.”**

The real devil on the subject of taxation of trusts having business income lies in Section 11(4A). *This sub section denies application of sub section 1, 2, 3 and 3A in relation to any income of a trust or an institution, being profits and gains of business, unless the business is incidental to the attainment of the objectives of the trust, or as the case may be, the institution and separate books of accounts are maintained by such trust or institution in respect of such business.*

Two issues, in the least, in this sub section, are trouble makers of a sort. One, meaning of the profit and gains of business and two, what is meant by “business incidental to the attainment of the objectives of the trust or as the case may be of the institution.”<sup>4</sup>

We must, however, start with an observation that income being profits and gains of business shall be eligible for the exemption on fulfillment of both the conditions cumulatively above. Failure to meet with either would be detrimental to exemption.

Second observation which is worth highlighting is that the sub section applies to all types of trusts or institutions, be it meant for advancement of any other object of general public utility to which the *proviso* to Section 2(15) applies or to all other trusts meant for charitable purposes included in that section. Section 11(4A) makes no distinction in the two categories.

The issue of meaning of income being profits and gains of business is dealt with first. The sub section states that the sub section 1, 2, 3 and 3A of the Section 11 shall not apply in relation to any income of a trust or institution, being profits and gains of business. Though the sub section falls short of saying that income chargeable to income tax under the head profits and gains of business or profession as specified in Section 28 of the Act, yet intent appears that it is meant that only. As the term income from profit and gains of business is not defined under the act, there is possibility of ambiguity. To illustrate the ambiguity, one may refer to Section 28 of the Act. The said section states that the income specified in that section shall be chargeable to income tax under the head profits and gains of business or profession. Clause (i) of the said section talks of the profits and gains of any business or profession which was carried on by the assessee at any time during the previous year and clause (iii) talks of income derived by a trade, professional or similar association from

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specific services performed for its members. Thus income under the head profits and gains of business or profession include incomes which are over and above the profits and gains of any business or profession.

Next trouble is the phrase “business incidental to the attainment of the objectives of the trust or the institution?” The application of this phrase needs to be scrutinised separately for:

- (a) trusts or institutions engaged, among others, in charitable purposes of the residual category of Section 2(15) and
- (b) trusts or institutions engaged in charitable purposes other than residual categories.

It has to be kept in mind that exemption u/s 11 is permitted to trusts wholly for charitable or religious purposes. Trusts having both charitable purposes and non-charitable purposes are not entitled to benefit of Section 11<sup>5</sup>. Therefore, trusts or institutions having business income have to pass through two thresholds; one of being charitable purposes as per Section 2(15) and two of Section 11(4) and 11(4A).

As far as Section 2(15) is concerned, businesses has no implication for trusts with charitable purposes specified in Section 2(15) other than residual category of advancement of any other object of general public utility. Therefore, trusts or institutions wholly for education, relief to the poor, medical relief etc., would be required to meet compliances with Section 11(4) and 11(4A) only.

It is trusts or institutions having purpose of advancement of any other object of general public

<sup>4</sup> From Definition of ‘Charitable purpose’ u/s. 2(15) of the Income-tax Act, 1961

<sup>5</sup> East India Industries (Mad) Private Limited Vs. CIT (1967) 65 ITR 611 (SC), Mohd. Ibrahim Vs. CIT (1930) 57 IA 260

utility that have to first cross the hurdle of *proviso* of Section 2(15) and having done so then have to overcome Section 11(4) and Section 11(4A).

Requirements of the *proviso* to Section 2(15) have been sufficiently analysed earlier. The relationship between the requirement of the *proviso* and the requirement of Section 11(4A) and what impact each one has over the other is an interesting question and is subject matter of discussion in this paragraph below.

Purpose of advancement of any other object of general public utility is not charitable if it involves carrying on an activity in the nature of trade, business or commerce or activity of any service in relation to trade, business and commerce unless as specified therein. Business activities which are undertaken in the course of actual carrying out of such advancement of any other object of general public utility, within the specified limit, however do not make the purpose non-charitable.

*Proviso* to Section 2(15) talks of something called “business activities undertaken in the course of actual carrying out such advancement of any other object of general public utility”. Section 11(4A) mentions “business incidental to the attainment of the objectives of the trust or institution.” The two phrases have not been defined anywhere in the act but have been dealt with in various court decisions.

Let us at this stage try and understand the types and nature of business/activities that a trust or institution can undertake. These types could be:

- (a) business undertaken as a property held under trust, income of which is used for advancement of the purposes of the trust or the institution (generally not connected with the purpose of trust)
- (b) business, held under trust, owned and run by the trust the income of which is used for advancement of the purpose of the trust (also generally not connected with purpose of the trust) and
- (c) when the advancement of the purposes is so undertaken (purely on commercial line) that purposes either fully or partly tantamount to business and its incomes are fully or partly used in advancement of the purpose of the trust.

On the other hand, activities in the course of actual carrying out the purpose of the trust or institution would be the ones which are undertaken



in the course of advancement of the purpose of the trust; and these may be charitable or non-charitable depending on facts specific situations determined in the light of detailed commentary made in the earlier part of this article. Business held under trust is not an activity carried on in the course of actual carrying out of advancement of any other object of general public utility. It is very important that it also cannot be held that the purpose of advancement of any other object of general public utility involves carrying out of an activity in the nature of trade, business and commerce or activity of rendering any service in relation to trade business and commerce.<sup>6</sup>

In conclusion, one can say that when business is held under trust with binding obligation that income from profits and gains of such business to be applied for advancement of the purposes of the trust, it can be said that business is incidental to the advancement of the purpose of the trust. It is for this reason that the income of the business undertaking held under trust by trusts meant for educational and other specified purposes other than advancement of any other object of general public utility are exempt subject to condition of maintaining of separate books of accounts u/s 11(4A) and stipulation as provided in Section 11(4)<sup>7</sup>.

Status of business in the case of trusts with purpose of advancement of any other object of general public utility should not be of any reckoning for determining whether the purpose of such trust is charitable or not. In case purpose of such trust is held to be non-charitable u/s 2(15), without taking business held under trust into consideration, trust being for non-charitable purpose, the income of such trusts will not be exempt. But income of business held under trust or carried on by the trust would be exempt from tax in case purpose is held to be charitable as per Section 2(15), such businesses being incidental to the advancement of purpose of the trust or the institution. ■

<sup>6</sup> From Definition of ‘Charitable purpose’ u/s. 2(15) of the Income-tax Act, 1961

<sup>7</sup> *ACIT vs. Thanthi Trust etc.*, (2001) 165 CTR 0681, 247 ITR 0785, (2001) 115 Taxman 0126, *Dharamdeepti vs. CIT* 114 ITR 454 ( SC)