

# Educational Institutions and Income Tax Act – An Overview



*In Indian taxation, educational institutions enjoy a privileged position. There are many tax exemption regimes available to educational institutions depending upon their constitution, objects, gross annual receipts and level of government finance they receive. Broadly, Section 10(23C) and Section 11 of the Income Tax Act contains the provisions applicable to educational institutions. Litigation goes hand in hand with tax exemption. Educational institutions are also not an exception. This article gives a bird's eye view of the taxability of educational institutions in India with reference to important judicial precedents. Read on to know more....*

## 1. Basic framework:

Before claiming the applicable exemption under the Income Tax Act by any educational institution, there should be a legally existent entity which can be registered and it should have a written instrument of creation or written document evidencing its creation (*Dept. guide on assessment of charitable trusts and institutions, 2013*). Therefore, generally, such institutions first get registered under the Societies Registration Act, 1860. Though, registration under

local trust act (such as Maharashtra Public Trusts Act in Maharashtra) is not a precondition to claim exemption under Income Tax Act, authorities generally ask for such registration under the local trusts act before granting registration/approval under Income Tax Act.

## 2. Income Tax Act:

2.1. Small educational institutions get covered under Section 10(23C)(iiiad) which reads as follows:

*(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;*



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Thus, institutions existing solely for educational purposes and not for profit whose aggregate annual receipts do not exceed ₹1 crore [Rule 2BC of the I.T. Rules] are eligible for tax exemption without any need for separate registration under Income Tax Act.

2.1.1. Controversy: Cap on annual receipts is institution wise or for the parent body as a whole?

Generally, a single parent body or a registered society runs various educational institutions under its banner. Books of accounts are separately maintained by all such educational institutions independently.

Each educational institution is a separate entity controlled under various statutes for various purposes. May be the management of these educational institutions would be in the hands of the single society or the trust, but for all other purposes they are different, independent entities.

If an assessee society is running several educational institutions, the threshold of ₹ 1 Crore is to be applied institution wise and not for the society as a whole. Therefore, every educational institution existing solely for educational purpose and not for the purpose of profit, if the aggregate annual receipts of such educational institution exceeds ₹ 1 crore, then the income from such educational institution received by the assessee is excluded from his total income.

In other words, while applying provisions of Section 10(23C)(iiiad) 'aggregate annual receipts' of all the educational institutions run by an assessee society are not to be clubbed. [CIT vs. Children's Education Society [2013] 34 taxmann.com 285 (Karnataka)]

Similar Views:

For purpose of exemption under Section 10(23C)(iiiad), 'aggregate annual receipts' refers to receipts by educational institution and not that of society. Receipts from more than one educational institutions run by assessee cannot be clubbed for the purpose of claiming exemption under Section 10(23C)(iiiad). [Refer: ACIT vs. Shiksha Samiti [2015] 60 taxmann.com 428 (Delhi), ADIT vs. Shushrutha Educational Trust [2016] 75 taxmann.com 194 (Bangalore), ITO vs. M/s Chironji Lal Virendrapal Saraswati Shiksha Parishad -ITA Nos.713 & 714/LKW/2014 (Luck), etc.]

**Every educational institution existing solely for educational purpose and not for the purpose of profit, if the aggregate annual receipts of such educational institution exceeds ₹1 crore, then the income from such educational institution received by the assessee is excluded from his total income.**

2.2. Educational institutions existing solely for educational purposes and wholly or substantially financed by Government are exempt from tax as per Section 10(23C)(iiiab) without any need for separate registration under the Income Tax Act:

(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

2.2.1. What is meant by 'wholly or substantially financed by the Government'?

To put this ever going controversy at rest, CBDT explained the term 'wholly or substantially financed by the Government' through Notification No. 79/2014 by way of insertion of Rule 2BBB as follows: 2BBB. For the purposes of sub-clauses (iiiab) and (iiiac) of clause (23C) of section 10, any university or other educational institution, 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 fifty per cent of the total receipts including any voluntary contributions, of such university or other educational institution, hospital or other institution, as the case may be, during the relevant previous year.

2.3. Other educational institutions not covered under sub-clause (iiiab) or (iiiad) of Section 10(23C) are dealt with by Section 10(23C)(vi) as follows:

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;

Thus, institutions existing solely for educational purposes and not for profit which are not

wholly or substantially financed by Govt. and aggregate annual receipts of which exceeds ₹1 crore, are required to obtain approval of Commissioner/Principal Commissioner of Income Tax by applying in prescribed form No. 56D. [Rule 2CA of I.T. Rules]

### 2.3.1. Some unique features of approval u/s. 10(23C) (vi) of the Act:

- The “educational institutions existing solely for educational purposes and not for purposes of profit” are only eligible for approval.
- Any activity of the approved institution or amendment in object clause by such institution which is not solely for educational purposes will result in cancellation of approval.
- No exemption u/s. 10(23C)(vi) shall apply in relation to any income of any university or other educational institution being profits and gains of business, unless the business is incidental to the attainment of its objectives and separate books of accounts are maintained by it in respect of such business. [Fourth proviso below sub-clause (vi) of Section 10(23C)]
- No exemption shall be allowed by the Assessing Officer under any of the clauses of S. 10(23C) in the case of a trust or institution for a previous year, if the provisions of the proviso to S. 2(15) become applicable in the case of such person in such previous year. [Third Proviso to S. 143(3)]

### 2.3.2. CBDT Circular No. 14/2015 dt. 17.08.15: Clarification on certain issues related to grant of approval and claim of exemption u/s. 10(23C)(vi) of the Income-tax Act, 1961: [Followed in Kanya Mahavidyalay vs. CIT (2017) 81 taxmann.com 474 (Amritsar)]

- Principles laid down by the Apex Court in *American Hotel and Lodging Association Educational Institute vs. CBDT* [301 ITR 86 (2008)] must be followed while considering

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the applications filed seeking approval for exemption u/s. 10(23C)(vi).

[Gist of *American Hotel's case*: At the time of granting approval u/s. 10(23C)(vi), the prescribed authority is to be satisfied that the institution existed during the relevant year solely for educational purposes and not for profit. Once the prescribed authority is satisfied about fulfillment of this criteria i.e. the threshold pre-condition of actual existence of an educational institution under Section 10(23C)(vi), it would not be justifiable, in denying approval on other grounds, especially where the compliance depends on events that have not taken place on the date on which the application for grant of approval has been made.]

- Section 10(23C)(vi) does not prescribe any stipulation which makes registration u/s. 12AA a mandatory pre or post condition. Hence obtaining prior registration before granting approval u/s. 10(23C) cannot be insisted upon.
- It is clarified that mere generation of surplus by educational institution from year to year cannot be a basis for rejection of application u/s. 10(23C)(vi) if it is used for educational purposes unless the accumulation is contrary to the manner prescribed under law.
- Collection of small and reasonable amounts under different heads of fee, which are essentially in the nature of fee connected with imparting education and do not violate any Central or State regulation does not, in general, represent a profit making activity. Hence, there is no justification for treating the charging of small amounts under different heads of fee as profit making activity unless the amount in the nature of ‘capitation fee’ is charged directly or indirectly. [Also refer: *Council for the Indian School vs. DGIT* - 45 taxmann.com 400 (Delhi)]
- There is no provision under the Act which calls for denial of exemption merely on account of appointment or removal of trustees. Hence, denial of exemption would not be justifiable only on the ground of induction of new trustees or removal of existing ones.

## 2.4. Alternate tax exemption regime—Section 11 to 13 of the Act:

Educational Institutions can alternatively claim exemption u/s. 11 r.w.s. 2(15) of the Act on the basis of its registration as charitable trust/Institution u/s. 12AA.

Section 2(15) of the I.T. Act, defines “Charitable purpose” as follows:

*S. 2(15): "Charitable purpose" includes relief of the poor, education, yoga, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest, and the advancement of any other object of general public utility:*

*Provided that the advancement of any other object of general public utility shall not be a charitable purpose, 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, 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 twenty per cent of the total receipts, of the trust or institution undertaking such activity or activities, of that previous year;*

There are six limbs of the above definition of charitable purpose:

- relief of the poor,
- education,
- yoga, (w.e.f. 01.04.16)
- medical relief,
- preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest
- the advancement of any other object of general public utility

The proviso to Section 2(15) will not apply in respect of the first five limbs of Section 2(15), i.e., relief of the poor, education, yoga, medical relief or preservation of environment [*ICAI vs. DGIT (2012) 347 ITR 99 (Del.)*]. Consequently, where the purpose

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of a trust or institution is say relief of poor, medical relief or education only, it will constitute 'charitable purpose' even if it incidentally involves the carrying on of commercial activities. [*Refer: CBDT Circular 11/2008 dated 19.12.2008*]

### Judicial reference:

***Hamdard Laboratories India vs. DIT (Exempt.) [2015] 61 taxmann.com 262 (Delhi)***

*Charitable purpose (Education)- Assessee 'H' was a registered trust engaged in activity of production, sale and marketing of unani and ayurvedic medicines, proceeds of which were applied for charitable purposes - DGIT(E) passed an order withdrawing exemption granted to 'H' under section 10(23C)(iv) on ground that its business was not incidental to attainment of its objects and it had applied as well as accumulated its income towards its business activities, which were not its object, and in view of amendment to section 2(15) with effect from 1-4-2009, 'H' could not be held to be existing for 'charitable purpose' - However, a look at H's Trust Deed and its activities unequivocally established that they were not guided by profit motive - Further, trust's scholarship schemes were directed towards encouraging students to pursue education, they fell under category of 'education' as opposed to residual category - this determination sufficiently established that H's objects fell within head of 'education', 'medical relief' and 'relief of poor', and not residual category under section 2(15) - therefore, H's objects were charitable in nature, and its activities relating to manufacture and sale of unani medicines and other allied businesses were only meant to act as a source of funds for its charitable activities, it was undisputedly a case of a business held in trust, and H had been consistently applying proceeds of its activities for charitable purposes - [In favour of Assessee]*

## 2.5. Interplay between S. 10(23C) and S. 11 of the Act:

It is important to note that, provisions of Section 11 and Section 10(23C) are two parallel regimes and

operate independently in their respective realms although some of the compliance criteria may be common to both.

Therefore, in case of a trust or an institution having obtained registration u/s. 12AA as well as approval u/s. 10(23C)(vi), if approval u/s. 10(23C)(vi) is withdrawn at some point of time due to certain adverse findings, the withdrawal of registration u/s. 12AA shall not be automatic but will depend upon whether these adverse findings also impact the conditions necessary to keep registration u/s. 12AA alive. [refer: CBDT Circular 14/2015 dated 17.08.15]

Accordingly, even if approval u/s. 10(23C)(vi) is withdrawn for any reason, educational institution can still be eligible to claim exemption u/s. 11, subject to fulfillment of conditions prescribed u/s. 11 to 13 as applicable to charitable trusts.

#### Judicial reference:

*Once all requisite conditions for exemption under Section 11 had been met by assessee, an educational society, then there would be no bar for assessee to seek exemption under Section 11 even if conditions under Section 10(23C) had not been complied with. [CIT vs. Mahasabha Gurukul Vidyapeeth Haryana- 2 DTLONLINE 283 (Punj. & Har.), Adarsh Public School vs. JCIT [2018] 90.taxmann.com 356 (Delhi)]*

CBDT also vide its instruction No. 1112 clarified that, in cases of violation of conditions laid down u/s. 10(22) [now Section 10(23C)], the applicability of Section 11 can be examined, and if the conditions laid down therein are satisfied, the income will be exempt u/s. 11.

#### **2.6. Impact on claim of exemption u/s. 11 by educational institution, if proviso to S. 2(15) is applicable:**

As discussed earlier, the proviso to Section 2(15) applies only to trusts/ institution falling in the last limb of the definition of 'charitable purpose', that too, if such trust/ institution carry on commercial activities necessarily in the nature of business, trade or commerce.

The proviso to Section 2(15) does not mean that in case an assessee receives any payment for anything done for trade, commerce or business, it will be hit by the said proviso. As clarified by CBDT also, the proviso applies only where the object of general public activity is a mask or device to hide

the true purpose of trade, business or commerce, or rendering of any service in relation thereto. It does not apply to cases where the services rendered are purely incidental to or subservient to the main objective of 'general public utility'.

The expression "trade", "commerce" or "business", as occurring in the proviso of Section 2(15) of the Act, must be read in the context of the intent in purported of Section 2(15) of the Act and cannot be interpreted to mean any activity which is carried on in an organised manner.

Where an institution is not driven primarily by a desire or motive to earn profits, but to do charity through the advancement of an object of general public utility, if the dominant object is not to carry on business or trade or commerce, then an incidental or ancillary activity for which a fee is charged does not destroy the character of a charitable institution. [India Trade Promotion Organization vs. DGIT (E) – W.P. No. 1872/2013 (Delhi)]

Taking another example, where an educational institution or other charitable trust is letting its infrastructure such as playground, hall etc. for marriage/ cultural functions and receives rental income therefrom. In this case also, until the predominant object of trust/institution is solely for education and not for profit and the incidental rental income is ultimately applied for objects of the trust, proviso to Section 2(15) cannot be applied to deny exemption to assessee u/s. 11 of the Act. *Therefore, by letting out function hall assessee trust can't be said to be involved in commercial activity so as to disentitle it from claiming exemption u/s. 11.* This logic also holds good in case of educational institutions enjoying exemption u/s. 10(23C) of the Act. [Refer: ITO vs. Kalinga Cultural trust-ITA No. 332/Hyd/2017 (Hyd.)]

However, if suppose, proviso to Section 2(15) becomes applicable to educational institution due to, say, any other new object pursued/activity carried on by such institution which can't be categorised as for educational purposes, and such

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new object is treated by revenue authorities as *any other object of general public utility u/s. 2(15) (last limb of definition)* and it incidentally involves carrying on of any commercial activity in the nature of trade, commerce or business, in the said eventuality, still exemption u/s. 11 shall be allowed subject to condition that, receipts from such other activity are less than 20% of total receipts of the assessee.

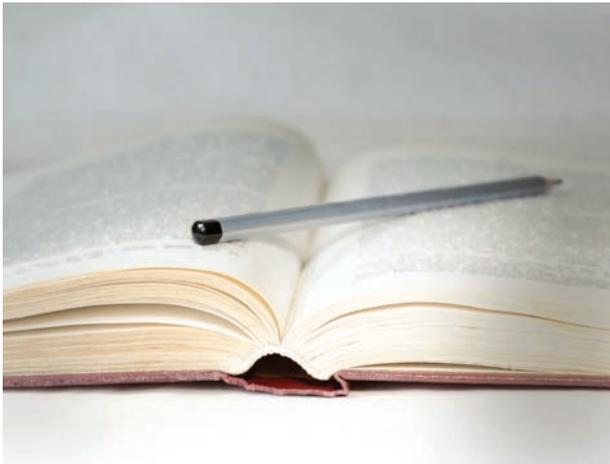
In a situation as mentioned above, as per Section 13(8) [as amended by F.A. 2012], no exemption u/s. 11 shall be allowed to any income of the trust, if the provisions of the proviso to Section 2(15) become applicable in the case of such trust in the said previous year. [*i.e. no exemption u/s. 11 to entire income of trust/institution only for the year in which receipts from such other activity i.e. any other object of general public utility are more than 20% of total receipts of the trust*]

Further, as clarified by CBDT in explanatory memorandum to F.A. 2012, this temporary excess [*receipts from other activity above 20%*] in one year will not be treated as altering the very nature of the trust or institution so as to lead to cancellation of registration or withdrawal of approval of trust or institution.

### 3. Procedural aspects:

#### 3.1. Filing of Return of Income:

As per Section 139(4A), every charitable trust, if its total income (the total income for this purpose being computed under this Act without giving effect to the provisions of Sections 11 and 12) exceeds the maximum amount which is not chargeable to income-tax, shall furnish a return of such income of the previous year in the prescribed form and all the



**W.e.f. A.Y. 18-19, no exemption u/s. 11 can be claimed by any trust unless it has furnished a return of income in accordance with provisions of sub-Section (4A) of Section 139, within the time allowed under that section.**

provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under sub-Section (1).

As per sub-clause (e) to Section 139(4C) of the Act, every university or other educational institution referred to in sub-clause (iiiab)\* or sub-clause (iiiad) or sub-clause (vi) of clause (23C) of Section 10, shall, if the total income in respect of which such university or other educational institution is assessable, without giving effect to the provisions of Section 10, exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under sub-Section (1).[\* w.e.f. from A.Y. 2016-17]

W.e.f. A.Y. 18-19, no exemption u/s. 11 can be claimed by any trust unless it has furnished a return of income in accordance with provisions of sub-Section (4A) of Section 139, within the time allowed under that Section. [*S. 12A(1)(ba)*]

#### 3.2. Furnishing of audit report:

Where the charitable trust/institution claiming exemption u/s. 11 is liable to file return of income as above, it is also liable to get its accounts audited and furnish audit report in form 10B. [*Section 12A(1)(b) r.w.r. 17B*]

Where the educational institution referred to u/s 10(23C)(vi) is liable to file return of income as above, it is also liable to get its accounts audited and furnish audit report in form 10BB. [*Tenth proviso to Section 10(23C)(vi) r.w.r. 16CC*]

### 4. Other miscellaneous issues:

#### 4.1. Whether pre-School would fall in the term 'education' as envisaged under Section 2(15)?

One cannot isolate 'education' given at one of the stages to say that it should not be treated as part of 'education'. The pre-schooling has become today a mandatory prelude to school education. It is like step number one in the ladder. If step number one

is taken properly, then other higher steps would be achievable more efficiently and effectively.

Thus, pre-schooling is very much integral part of the term 'education' as has been envisaged under Section 2(15).

4.2. *Whether charging of fee and retaining surplus amounts to commercial activity, disentitling an assessee, an educational institute, from the benefit of exemption under Sections 11 and 12?*

It has not been stipulated under the statute that for the purpose of getting the benefit of exemption under Sections 11 and 12 by the educational institutions, the assessee must carry out all its activities free of cost i.e. without charging anything from anyone. Rather as per Section 2(15), the term 'charitable purpose' includes *inter alia* 'education'.

To decide whether the institution exists solely for education and not to earn profit the test of predominant object of the activity has to be seen to decide. The purpose does not lose its character merely because some profit arises from the activity. *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.* The assumption that for exemption there should not be any surplus otherwise the institution society exists for profit and not for charity is not justified. [*St. Lawrence Educational Society vs. CIT- WP No. 1254/2010 (Delhi), Vanita Vishram Trust vs. CCIT – WP No. 366 of 2010 (Bombay), etc.*]

Thus, when the carrying out of the activity of 'education' itself is a charitable purpose, then at the stage of granting registration under Section 12A, the DIT is required to examine only the genuineness of the activities of the trust. Thus, the DIT may examine at this stage that activities of the trust are as per the objects contained in the trust deed or its memorandum. He is neither permitted nor obliged under the law, to go beyond that at the stage of registration. [*Green Acres Educational Trust vs. DCIT [2016] 70 taxmann.com 347 (Mumbai)*]

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4.3. *Whether a private Limited Company can be an 'institution' for the purpose of S. 10(23C)?*

Private limited company could be registered under Section 25 of Companies Act, 1956 and therefore such company was eligible institution for exemption under Section 10(22A) [now S. 10(23C)] – *CIT vs. Apeejay Medical Ltd.(2016) 68 taxmann.com 10(Cal.)*

4.4. *What is the connotation of the word 'any income' appearing in Section 10(23C)?*

U/s. 10(23C), any income of educational institution is exempt if it is existing solely for the educational purposes and not for purposes of profit. What is entitled for exemption u/s.10(23C) is "any income"; the word 'income cannot be given restrictive meaning but its natural meaning, therefore, the use of the word 'any income' in Section 10(23C) is wide enough to include deemed income under Section 68 of the Act. [*ACIT vs. Gurudatta Shikshan Sanstha [2017] 87 taxmann.com 214 (Pune)*]

**Conclusion:**

Income Tax Act favours only genuine educational institutions/trusts subject to approval/registration under the Act, wherever necessary. And, if there is any deviation from basic objective of imparting education by such institutions to make profits, the Act is well equipped to bring this mischief within the tax bracket. There is no bar in undertaking commercial activities by such institutions, so long as these activities are incidental and essential in the given circumstances in order to achieve the prime objective of education. As far as any other object of general public utility pursued by these institutions is concerned, commercial activities are permissible only to certain extent and only if these activities are incidental to the attainment of such objects. ■