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IN THE HIGH COURT OF PUNJAB AND HARYANA AT

CHANDIGARH.

CWP No. 6031 of 2009

Date of Decision: January 29, 2010

Pinegrove International Charitable Trust

…Petitioner

Versus

Union of India and others

…Respondents

CORAM: HON'BLE MR. JUSTICE M.M. KUMAR

HON'BLE MR. JUSTICE JASWANT SINGH

Present: Mr. Sanjay Bansal, Senior Advocate, with
Mr. Prashant Bansal, Advocate,
Mr. Ravi Shankar, Advocate,
Mr. Pankaj Jain, Advocate,
Mr. Akshay Bhan, Advocate,
Mr. N.L. Sharda, Advocate,
Ms. Radhika Suri, Advocate,
Mr. Ravish Sood, Advocate,
Mr. Vishal Gupta, Advocate,
Mr. Sunish Bindlish, Advocate,
for the petitioner(s).

Mr. S.K. Garg Narwana, Advocate,
Ms. Urvashi Dhugga, Advocate,
Mr. Rajesh Sethi, Advocate, and
Mr. Vivek Sethi, Advocate,
for the revenue.

1. To be referred to the Reporters or not? Yes
2. Whether the judgment should be reported in the Digest? Yes

M.M. KUMAR, J.

1.1 This order shall dispose of a bunch[2] of petitions as the issues raised in all these cases are common. Civil Writ Petition No. 6031 of 2009 has been treated as a lead case. However, the facts of all the cases in brief shall also be referred to after noticing facts in detail in the lead

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case.

FACTS IN THE LEAD CASE

2.1 Like all other petitions, CWP No. 6031 of 2009 has also been filed under Article 226 of the Constitution with the prayer for quashing order dated 30.3.2009 (P-1). The impugned order passed by the Chief Commissioner of Income Tax, Chandigarh-respondent No. 2, has withdrawn the exemption granted under Section 10(23C)(vi) of the Income-tax Act, 1961 (for brevity, 'the Act') read with Rule 2CA of the Income-tax Rules, 1961 (for brevity, 'the Rules), from the Assessment Year 2000-01 onwards. The exemption was granted to the petitioners, vide order dated 31.5.2007/4.6.2007 (P-2), which has now been withdrawn.

2.2 Brief facts of the case may first be noticed. The petitioner-society is running a school solely for educational purposes. It has also claimed that its purpose is not to make profit and it is being regularly assessed by the Assessing Officer at 'Nil' income on account of exemption from payment of income tax had been granted, vide order dated 31.5.2007 (P-2) by respondent No. 2. The Income Tax Officer, vide letter dated 31.12.2008/6.1.2009 (P-3) informed the petitioner-society that as per the provisions of the Act, approval in terms of Section 10(23C) of the Act could only be granted to a University or educational institution; and not to a Society/Trust. Therefore, seeking to comply with the provisions of the statute a list of institutions being run by the petitioner-society was requisitioned so that the exemption, which had been granted, could be amended.

2.3 The petitioner-society in response to the letter dated

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3.12.2008/6.1.2009 (P-3) filed a reply giving details of excess of income over expenditure before depreciation and capital expenditure incurred by the school run by it from the Assessment Year 2006-07 as had been asked for and submitted that the phraseology of the provisions of Section 10 (23C)(vi) of the Act, namely, "*Other educational Institution*" would encompass the educational institutions run by a society registered under the Societies Registration Act, 1860 (for brevity, 'the 1860 Act'), inasmuch as, the term '*educational institution*' or '*institution*' has nowhere been defined in the Act. It was submitted that the educational institution run by the society could only be regarded as one falling within the ambit of '*other educational institution*' and, therefore, it would fall within the provisions of Section 10(23C) of the Act (P-4). It has also been submitted that without affording an opportunity of hearing, show cause notice dated 11.3.2009 (P-5), was issued to the petitioner-society, inter-alia, stating as to why exemption granted to it be not withdrawn and reliance in that regard was placed on the judgment of Uttrakhand High Court rendered in the case of **CIT v. M/s Queens Educational Society, (2009) 177 Taxman 326**.

2.4 On 30.3.2009 (P-6), the petitioner-society furnished reply to the show cause notice reiterating the stand taken in its earlier reply dated 31.12.2008 (P-3), where reliance was placed on a judgment of Hon'ble the Supreme Court in the case of **Aditanar Educational Institution v. Additional Commissioner of Income-tax, [1997] 224 ITR 310**. It was further submitted that a running institution is bound to have either surplus or deficit income and expenditure account. If there is a surplus of income over expenditure then it does not necessarily imply that the society is

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running into profit. It was also pointed out that the provisions of Sections 11, 12A and 10(23C)(vi) of the Act have been enacted keeping in view that the society must be generating surplus and as per proviso 85% of the income has to be applied during the year for charitable purposes. In case there is constant deficit in the society, it is bound to close down for want of funds. In case of charitable organizations, it is the receipt and application of total funds, whether of revenue nature or of capital nature, which is to be considered and not the incidental surplus generated as excess of income over expenditure. It was further submitted that the activity of imparting education is a charitable activity as defined in Section 2(15) of the Act. A proviso was also added in Section 2(15) by an amendment vide Finance Act, 2008, which stipulates that the advancement of any other object of general public utility was not to be a charitable purpose if it involved carrying on any activity in the nature of trade, commerce or business and 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 income from such activity. The Central Board of Direct Taxes (for brevity, 'the CBDT') vide circular dated 19.12.2008, has clarified that the newly added proviso was not to apply in respect of first three limbs of Section 2(15) i.e. relief to the poor, education or medical relief and it would constitute charitable purpose even if it incidentally involved carrying on of commercial activity. In response to the detailed reply (P-6) submitted by the petitioner-society, the Chief Commissioner of Income Tax-respondent No. 2, vide order dated 30.3.2009 (P-1) withdrew the exemption.

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2.5 It is pertinent to notice that after grant of exemption vide order dated 31.5.2007/4.6.2007 (P-2), assessments in respect of Assessment Years, namely, 2000-01 upto 2007-08 have been framed under Section 143(3) of the Act. The petitioner-society has urged that withdrawal of exemption by respondent No. 2 is without application of mind and without evaluating the character and objects of the society on the basis of which exemption had been earlier granted, vide order dated 31.5.2007/4.6.2007 (P-2), under Section 12AA of the Act by treating the petitioner as a charitable institution. Earlier exemption was granted to the petitioner society under Section 80GT and 12AA of the Act after being satisfied that the petitioner-society is an institution solely existing for charitable purposes and not for profits. The operative part of the order passed by the Chief Commissioner reads as under:-

> "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.
>
> 5. The Hon'ble Supreme Court has held, in the case of Aditanar Educational Institution etc. vs. 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.
>
> 6. The crucial condition is that surplus should result only incidentally and should not be aimed for. If substantial

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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 then it cannot be said that the surplus is arising incidentally.

7. In the present case, the profits are substantial and are arising year after year and, therefore, the decision of the Apex Court in the case of Aditanar Education Institution vs. 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 04.06.2007 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."

BRIEF FACTS OF CONNECTED CASES:

CWP No. 7113 of 2009

3.1 Indo Global Education Foundation-petitioner Society is running four colleges for educational purposes. On 27.2.2007/ 5.3.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act read with Rule 2CA of the Rules from Assessment Year 2003-04 onwards (P-2). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-

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06, 2006-07 and 2007-08, the Chief Commissioner of Income-tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-1).

CWP No. 7857 of 2009

3.2 Shri Raghu Nath Rai Memorial Educational and Charitable Trust-petitioner is running ten colleges for educational purposes. On 21.8.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2006-07 onwards (P-2). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 27.3.2009 withdrawing the exemption (P-1).

CWP No. 9504 of 2009

3.3 Sikh Educational Society-petitioner has claimed that its main objects are to impart to the youths an education that will make them intelligent, patriotic and useful citizens of India by establishing, maintaining and managing educational institutions viz. Colleges and Schools or by taking over the control and management of the existing institutions. On 7.3.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10 (23C)(vi) of the Act from Assessment Year 2007-08 onwards (P-3). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the

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exemption (P-6).

CWP No. 6834 of 2009

3.4 Sanjay Gandhi Educational Society-petitioner has claimed that its main object is to establish and run educational institutions in order to provide education to different sections of society, especially orphans, handicapped, children of destitute mothers/widows, weaker sections of society, economically weaker sections of society and other Backward Classes, Scheduled Castes and Scheduled Tribes and other deserving children and to do all such other things as are incidental or conducive to the attainment of its aims and objects. On 27.8.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2007-08 onwards (P-3). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-6).

CWP No. 9777 of 2009

3.5 Kandi Friends Educational Trust-petitioner has claimed that its main objects are to impart technical, management and job-oriented Pharmacy education so as to help the youth to seek job and self-employed occupation as also to raise infrastructure to impart such education as has been denied to the Backward Classes, Scheduled Castes, Scheduled Tribes and economically backward communities. Further to do all such other things as are incidental or conducive to the attainment of the aforementioned aims and objects. On 30.5.2007, it was granted

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exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2002-03 onwards (P-3). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-6).

CWP No. 7422 of 2009

3.6 Rayat Educational and Research Trust-petitioner has claimed that for the last more than eight years it is engaged in the activity of providing education by running various courses and is affiliated to various universities/authorities. On 29.12.2006, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act effective from the Assessment Year 2002-03 onwards (P-5). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-6). It has been held by the Chief Commissioner that the aggregate gross profits of the petitioner in the last three years is 31.08% excluding depreciation, which is only a notional deduction. According to the Chief Commissioner it is the income before depreciation which is the indicator of profit margin as well as the pricing of services done by the petitioner-assessee. It has also been observed that it would be duty of the institution to lower its fees for the subsequent year so that such profits are not

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intentionally generated. Accordingly, liberty has been granted to the petitioner to reduce the fees being charged and price of its services and apply afresh.

CWP No. 7391 of 2009

3.7 St. Stephen's Educational Society-petitioner has claimed that it has been engaged for the last twenty five years in the activity of providing education through a school in the name of St. Stephen's School, Sector 45, Chandigarh, which is affiliated with the Central Board of Secondary Education, New Delhi. It has further been asserted that the petitioner's Society is an educational institution existing solely for educational purposes and not for the purposes of earning profit. On 2.4.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2003-04 onwards (P-3). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-6).

CWP No. 7346 of 2009

3.8 Gian Jyoti Educational Society-petitioner has claimed that it is an educational institution existing solely for educational purposes and not for the purposes of earning profit. It has been running Gian Jyoti Public School and Gian Jyoti Institute of Management and Technology. On 20.2.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the

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Act from Assessment Year 2004-05 onwards (P-5). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-9).

CWP No. 7082 of 2009

3.9 St. Joseph's Educational and Charitable Trust-petitioner has claimed that it has been engaged for the last more than twenty years in the activity of providing education through a school in the name of St. Joseph's School, Sector 37-B, Chandigarh, which is affiliated with the Central Board of Secondary Education, New Delhi. It has further been asserted that the petitioner is an educational institution existing solely for educational purposes and not for the purposes of earning profit. On 21.6.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2002-03 onwards (P-2). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-5).

CWP No. 7065 of 2009

3.10 Shishu Niketan Model School-petitioner has claimed that it has been engaged for the last more than 40 years in the activity of providing education through schools at Chandigarh, Panchkula and

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Mohali, which are affiliated with the Central Board of Secondary Education, New Delhi. It has further been asserted that the petitioner is an educational institution existing solely for educational purposes and not for the purposes of earning profit. On 4.6.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2002-03 onwards (P-3). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-5).

CWP No. 7042 of 2009

3.11 Shivalik Educational Society-petitioner has claimed that it has been engaged for the last more than 35 years in the activity of providing education through four schools, which are affiliated with the All India Central Board of Secondary Education, New Delhi. It has further been asserted that the petitioner is an educational institution existing solely for educational purposes and not for the purposes of earning profit. On 19.6.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10 (23C)(vi) of the Act from Assessment Year 2005-06 onwards (P-3 Colly). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-6).

CWP No. 7031 of 2009

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3.12 Sant Educational and Welfare Society-petitioner has claimed that it has been engaged for the last more than 15 years in the activity of providing education through a school in the name of Sahibzada Ajit Singh Academy, Simran Nagar, Roopnagar, Punjab, which is affiliated with the Central Board of Secondary Education, New Delhi. It has further been asserted that the petitioner is an educational institution existing solely for educational purposes and not for the purposes of earning profit. On 16.8.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10 (23C)(vi) of the Act from Assessment Year 2007-08 onwards (P-3). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-6).

CWP No. 7030 of 2009

3.13 St. Peter's Educational Society-petitioner has claimed that it has been engaged for the last more than 20 years in the activity of providing education through a school in the name of St. Peters School, Sector 37-B, Chandigarh, which is affiliated with the Central Board of Secondary Education, New Delhi. It has further been asserted that the petitioner is an educational institution existing solely for educational purposes and not for the purposes of earning profit. On 19.2.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2003-04 onwards (P-3). Upon review of the

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aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-6).

CWP No. 5649 of 2009

3.14 Baba Banda Singh Bahadur Education Trust-petitioner has claimed that it has been engaged in the activity of providing education. On 24.1.2008, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act from Assessment Year 2007-08 onwards. Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 27.3.2009 withdrawing the exemption (P-2).

CWP No. 5562 of 2009

3.15 Gulab Devi Memorial Hospital Trust-petitioner has claimed that it has been engaged in the activity of providing education. On 7.10.2005, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) & (via) of the Act from Assessment Years 2005-06 to 2007-08. Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Assessment Years 2002-03 to 2006-07, the Chief Commissioner of Income Tax, Ludhiana, passed the impugned order dated 23.3.2009 withdrawing the exemption (P-3). In para 2 of the order it has been observed that during the course of

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assessment proceedings in respect of Assessment Year 2006-07 the Assessing Officer noticed that the petitioner-Trust is not functioning as per the objects mentioned in the Trust Deed as it is not existing solely for purpose of education/medical services and there is an element of profit involved. This is evident from the surplus on account of fees etc. charged for the services rendered. After referring to the show cause notice dated 13.1.2009, reply submitted by the petitioner and various judgments, the Chief Commissioner came to the conclusion that the total surplus of the petitioner is ranging from 18.59% to 28.66% in the last five years, which cannot be regarded as merely incidental to the main purposes. The surpluses/profits generated are systematic and substantial. The Chief Commissioner also negated the plea of the petitioner that the surplus has been accumulated for further creation of infrastructure. It has been held by the Chief Commissioner that the petitioner is generating continuously surplus income year after year.

CWP No. 3727 of 2009

3.16 Khalsa College-petitioner has claimed that it has been running various educational institutions in Jalandhar in the State of Punjab. On 25.3.2008, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10 (23C)(vi) & (via) of the Act read with Rule 2CA of the Rules from Assessment Year 2005-06 onwards (P-7). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the year ending on 31.3.2004, 31.3.2005 and 31.3.2006, the Chief Commissioner of Income Tax, Ludhiana, passed the impugned order dated 3.2.2009 withdrawing the

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exemption (P-10). In para 2 of the order it has been observed that during the course of assessment proceedings in respect of Assessment Year 2006-07 the Assessing Officer noticed that the petitioner-Trust is not functioning as per the objects mentioned in the Trust Deed as it is not existing solely for purpose of education/medical services and there is an element of profit involved. This is evident from the surplus on account of fees etc. charged for the services rendered. After referring to the show cause notice dated 15.1.2009, reply submitted by the petitioner and various judgments, the Chief Commissioner came to the conclusion that the total surplus of the petitioner is ranging from 17.86% to 71.30% in the last three years, which cannot be regarded as merely incidental to the main purposes. The surpluses/profits generated are systematic and substantial. The Chief Commissioner also negated the plea of the petitioner that the surplus has been accumulated for further creation of infrastructure. It has been held by the Chief Commissioner that the petitioner is generating continuously surplus income year after year.

CWP No. 5978 of 2009

3.17 Montgomery Guru Nanak Educational Trust-petitioner has claimed that it has been imparting education to the community since its inception in the year 1974. On 23.2.2000, it was initially granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act for the Assessment Year 1999-2000 to 2001-02. Further extension was granted to it by the CCIT, Ludhiana vide order dated 4.5.2005 in respect of assessment year 2002-03 to 2004-05. Still further renewal was granted vide orders dated 24.11.2005 and 7.4.2008 in respect of the Assessment Years 2005-06 to

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2007-08 and 2008-09 onwards respectively (P-4 & P-5). However, on 13/14.1.2009 a show cause notice was issued for withdrawal of exemption granted under Section 10(23C)(vi) of the Act. Reply was filed by the petitioner. Subsequently, after considering the details of income/expenditure statements for the year ending on 31.3.2002, 31.3.2004, 31.3.2005 and 31.3.2006, the Chief Commissioner of Income Tax, Ludhiana, passed the impugned order dated 18.2.2009 withdrawing the exemption (P-8). In para 2 of the order it has been observed that during the course of assessment proceedings in respect of Assessment Year 2006-07 the Assessing Officer noticed that the petitioner-Trust is not functioning as per the objects mentioned in the Trust Deed as it is not existing solely for purpose of education/medical services and there is an element of profit involved. This is evident from the surplus on account of fees etc. charged for the services rendered. After referring to the show cause notice, reply submitted by the petitioner and various judgments, the Chief Commissioner came to the conclusion that the total surplus of the petitioner is ranging from 41.66% to 65.05% in the last four years. It has further been noticed that if the notional expenditure of depreciation is excluded then the profits/surpluses have ranged from 61.03% to 75.14%. Therefore, it has been concluded that the surpluses/profits generated by the petitioner cannot be regarded as merely incidental to the main purposes. The surpluses/profits generated are systematic and substantial. The Chief Commissioner also negated the plea of the petitioner that the surplus has been accumulated for further creation of infrastructure. It has been held by the Chief Commissioner that the petitioner is generating continuously surplus income year after year.

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CWP No. 8317 of 2009

3.18 Smt. Savitri Bhagwan Dass Kaura Education Society-petitioner has claimed that it has been running a school solely for educational purposes and not for the purposes of making profit. On 27.3.2008, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act effective from the Assessment Year 2007-08 onwards (P-2). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-1).

CWP No. 7038 of 2009

3.19 Saint Soldier Education Society-petitioner has claimed that it has been running a school solely for educational purposes and not for the purposes of making profit. On 15.2.2008, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act effective from the Assessment Year 2008-09 onwards (P-2). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-1).

CWP No. 8912 of 2009

3.20 National Educational Development Trust-petitioner has claimed that it has been engaged for the last more than 25 years in the

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activity of providing education by running Ajit Karam Singh International Public Schools. On 5.11.2007, it was granted exemption from payment of income tax by the Chief Commissioner of Income Tax, under Section 10(23C)(vi) of the Act effective from the Assessment Year 2000-01 onwards (P-5). Upon review of the aforementioned order and after considering the details of income/expenditure statements for the Financial Years 2005-06, 2006-07 and 2007-08, the Chief Commissioner of Income Tax, Chandigarh, passed the impugned order dated 31.3.2009 withdrawing the exemption (P-8).

3.21 It is appropriate to notice that in all the above cases the primary reliance has been placed by the Chief Commissioner of Income Tax on the judgment of Hon'ble the Supreme Court rendered in the case of **Aditanar Education Institution (supra)** and judgment of Uttrakhand High Court in the case of **M/s Queens Educational Society (supra)**. It has been held by the Chief Commissioner that the petitioner is generating continuously surplus income year after year. It has also been observed that it would be duty of the institution to lower its fees for the subsequent year so that such profits are not intentionally generated. Accordingly, liberty has been granted to the petitioner to reduce the fees being charged and price of its services and apply afresh.

RIVAL CONTENTIONS

4.1 Learned counsel, namely, Mr. Sanjay Bansal, Mr. Ravi Shankar, Mr. Akshay Bhan, Mr. N.L. Sharda, Ms. Radhika Suri, Mr. Ravish Sood, Mr. Vishal Gupta and Mr. Sunish Bindlish, have advanced arguments on behalf of the petitioner(s).

4.2 Learned counsel for the petitioners have submitted that the

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impugned order(s) passed by the Chief Commissioner of Income Tax withdrawing exemption retrospectively on the same set of facts on which exemption earlier stood granted, is contrary to the well settled principle of law. The power of review is not an inherent power but is a creature of a statute which is not exercisable until and unless such a power of a review is conferred expressly by necessary implication on an authority and/or Court. It has been submitted that the Chief Commissioner in view of the un-numbered 13th proviso to Section 10(23C) of the Act is empowered to withdraw the exemption only on the grounds mentioned therein. In the case of the petitioner-society the exemption has not been withdrawn on the grounds specified in the 13th proviso of Section 10 (23C) of the Act. According to the learned counsel, the impugned order withdrawing exemption retrospectively is, thus, totally illegal and without jurisdiction.

4.3 Learned counsel then submitted that the impugned order dated 30.3.2009 (P-1) is ultra vires the provisions of the Act. In view of the proviso to Section 147 of the Act the assessments stood framed and finalized for the earlier assessment years by granting benefit of the exemption. Therefore, the same could not be re-opened by the Assessing Officer even if the impugned order withdrawing exemption is held to be valid though not admitted to be sustainable in law. The exercise undertaken by the Chief Commissioner of Income Tax withdrawing exemption retrospectively has, thus, been passed with total non-application of mind and failure to act judiciously. Therefore, the same deserves to be set-aside on the ground of arbitrariness.

4.4 According to the learned counsel the impugned order is not

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sustainable in law in view of the judgment of Hon'ble the Supreme Court rendered in the case of **American Hotel and Lodging Association v. Central Board of Direct Taxes, [2008] 301 ITR 86**. In that case it has been held that if at the threshold pre-conditions are fulfilled then exemption has to be granted and as per the provisos to Section 10(23C) of the Act monitoring conditions have been laid down, which have to be examined at the time of assessment whereas in the case of the petitioner-society, the Chief Commissioner of Income Tax has not mentioned any violation on the part of the assessee, which may attract the proviso to Section 10(23C)(vi)of the Act nor anything adverse has ever been found by the Assessing Officer or the Chief Commissioner of Income Tax, warranting the exercise of power in terms of un-numbered 13th proviso for withdrawing the exemption which stood granted to the petitioner-society. Thus, the impugned order vide which exemption has been withdrawn retrospectively is in contravention of the principles of law laid down by Hon'ble the Supreme Court in the case of **American Hotel and Lodging Association (supra)**. It has been submitted that the conclusion arrived at on the material and evidence on record by the Chief Commissioner of Income Tax while withdrawing exemption when viewed in the light of the principles and tests laid down by Hon'ble the Supreme Court it becomes unsustainable. He has argued that there are two reasons for the aforesaid view. Firstly, it has not been disputed by the Chief Commissioner that the petitioner-society exists solely for educational purposes. Secondly, even if there is any substantial profit resulting in surplus with the petitioner-society the institution would not cease to be not existing solely for educational purposes, inasmuch as,

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surplus/deficit is not determinative of the question as to whether the petitioner-society exists for making profit. Thus, the findings recorded by the Chief Commissioner would have no bearing which attract the grounds of withdrawal laid down in **American Hotel and Lodging Association's case (supra),** especially when he observed that if substantial profits are earned in one year it would be the duty of the institution to lower its fees for the subsequent year so that such profits are not intentionally generated and if profits continue year after year then it could not be said that surplus is arising incidentally. Such reasoning is wholly irrelevant, inasmuch as, even if there is substantial surplus the institution can not cease to be one existing solely for educational purposes.

4.5 Another significant submission urged by the learned counsel is that the methodology adopted by the Chief Commissioner while computing surplus by not deducting the capital expenditure incurred by the petitioner-society from the gross income is contrary to the un-numbered third proviso to Section 10(23C)(vi) of the Act. The words '*not for the purposes of profit*' accompanying the words '*existing solely for educational purposes*' has to be read and interpreted in view of un-numbered third proviso to Section 10(23C) of the Act, which prescribes the methodology for the utilization and accumulation of income at the hands of the educational institutions by imposing two restrictions, namely, (i) accumulation of surplus upto 15% can be for any number of years by the educational institution for which purposes it is established; and (ii) if the accumulation is more than 15% of the income the same can be accumulated for a maximum period of 5 years to be utilized for

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achieving the objects of the society. According to the learned counsel the inevitable consequence is that 85% of the income has to be applied for its objects by the petitioner-society. As per the provisions of Section 10 (23C)(vi) read with the third proviso thereof, the capital expenditure, if incurred by the petitioner-society for the attainment of the objects of the society, has to be deducted from its gross receipts/income. This is so because the third proviso contains the expression '*applies its income, or accumulates it for application or, wholly and exclusively to the objects for which it is established*'. The expression '*wholly*' refers to the quantum of expenditure, whereas the expression '*exclusively*' refers to the motive, object or the purpose of expenditure. It has been urged that the petitioner-society, when admittedly having utilized more than 100% of the income for achieving its objects could by no stretch of imagination, be held to be an educational institution existing for the purposes of making profit so as not to be entitled to exemption in view of the provisions of Section 10(23C) (vi) of the Act. The Chief Commissioner has failed to keep in focus the third proviso while wrongly holding that since the substantial profits are being earned year after year it could not be said that the surplus is arising incidentally and therefore, the petitioner-society was not entitled to exemption.

4.6 It has been urged that the judgment of Hon'ble the Supreme Court rendered in the case of **Aditanar Educational Institution (supra)**, as relied upon by the Chief Commissioner while withdrawing the exemption of the petitioner-society, when applied in view of un-numbered third proviso to Section 10(23C)(vi) of the Act, in fact, squarely covers the issue in favour of the petitioner-society. Learned

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counsel has emphasised that though the said decision was rendered by Hon'ble the Supreme Court under the earlier provisions of Section 10 (22) of the Act dehors the third proviso, yet the provisions have been held to be analogous to Section 10(23)C(vi) of the Act by Hon'ble the Supreme Court in the case of **American Hotel and Lodging Association (supra)**, wherein it has been further held that the judgments rendered by Hon'ble the Supreme Court as applicable to Section 10(22) would equally apply to section 10(23C)(vi) of the Act.

4.7 While referring to the judgment of Hon'ble the Supreme Court rendered in the case of **Municipal Corporation of Delhi v. Children Book Trust**, **AIR 1992 SC 1456,** which has been made the basis by the Chief Commissioner for withdrawing the exemption, learned counsel has submitted that the same is not applicable to the cases under Section 10(23C)(iv) of the Act, primarily for the reason that the provisions under which the said judgment has been rendered are not *pari materia* to the provisions relating to exemption, namely, Section 10(23C) of the Act, apart from the scheme of the Acts being totally different.

4.8 Learned counsel have then referred to the judgments of Uttrakhand High Court rendered in the case of **Queens Educational Society (supra)** and other connected matters like **M/s Saint Pauls Senior Secondary School,** which have been made the basis for withdrawing the exemption by the Chief Commissioner, and submitted that the same are not applicable to the case of the petitioner-society. He has submitted that there the scope of the un-numbered third proviso was not under consideration, inasmuch as, the case before the Uttrakhand High Court pertained to Section 10(23C)(iiiad) of the Act, to which the provisions of

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the third proviso had no application. Moreover, the third proviso to Section 10(23C)(vi) is not applicable to the cases falling within the purview of Section 10(23C)(iiiad). According to the learned counsel the judgment rendered by the Uttrakhand High Court runs contrary to the provisions of Section 10(23C)(vi) of the Act including the provisos thereunder equivalent to the provisions of Section 10(22) existing earlier, which were introduced with effect from 1.4.1999.

4.9 It has also been argued that there is failure to take into consideration the speech of the Finance Minister made before the introduction of Section 10(23C) of the Act, which had clarified that the educational institutions were required to file their returns of income and make an application for exemption after adhering to certain conditions which are similar to those prescribed for persons deriving income from profit held for charitable or religious purposes. The background of the proposal was that large number of educational medical institutions exist as profitable commercial venture yet they continue to enjoy exemption without filing their returns of income. Keeping in view the interest of small educational and medical institutions, the Finance Minister had mooted the proposal that the institutions whose annual receipt did not exceed Rs. 1 crore were also continue to avail this exemption as in the past. However, in respect of educational medical institutions churning out annual receipt exceeding Rs. 1 crore would be required to follow the same conditions as are prescribed for institutions and Trusts established for charitable purposes or for public religious purposes. The proposal further was that all educational and medical institutions which are financed and managed by the Government should continue to enjoy the

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benefit of exemption.

4.10 Learned counsel have substantiated their arguments by submitting that the Uttrakhand High Court has not appreciated correctly the ratio of the judgments of Hon'ble the Supreme Court in the cases of **Aditanar Educational Institution (supra)** and **Children Book Trust (supra)** and lost sight of the amendment which had been carried out with effect from 1.4.1999 leading to the introduction of the provisions of Section 10(23C) of the Act. It does not take the correct view of the judgment of Hon'ble the Supreme Court rendered in the case of **American Hotel & Lodging Association Educational Institute (supra)**. According to the learned counsel, in principle the judgment of Uttrakhand High Court is in direct conflict with the decision rendered by the High Court of Allahabad in the case of **City Montessori School v. Union of India and Others, (decided on 29th of May, 2009)**. Learned counsel has also apprised the Court that the Special Leave Petition preferred against the decision in City Montessori School's case, has been dismissed by Hon'ble the Supreme Court.

4.11 It has been further submitted that the Uttrakhand High Court has decided the controversy arising from the regular assessment proceedings which had emerged as a result of disallowance of capital expenditure thereby treating it as profit of the assessee at the hands of the Assessing Officer within whose jurisdiction the question of allow-ability of such an expenditure had arisen, though the genuineness of the existence of the Trust was not doubted.

CONTENTIONS OF THE REVENUE

5.1 Mr. S.K. Garg Narwana, Ms. Urvashi Dhugga, Mr. Rajesh

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Sethi and Mr. Vivek Sethi, learned counsel for the revenue, have then made their submissions. They have supported the order of the Chief Commissioner of Income Tax and argued that no exemption under Section 10(23C)(vi) of the Act would be available to the petitioner because it is a Society registered under the 1860 Act and would not fall within the ambit of expression '*other educational institutions*' as used in Section 10(23C)(iv) of the Act. Referring to the written statement filed on behalf of the respondents it has been submitted that once the educational society like the petitioner is accumulating systematic profits then it would not qualify to avail exemption in terms of Section 10(23C)(iv) of the Act. In that regard reliance has been placed on the Division Bench judgment of Uttrakhand High Court rendered in **M/s Queens Educational Society's case (supra)**. According to the learned counsel the Division Bench of the Uttrakhand High Court has rightly taken the view that accumulation of surpluses year after year would necessarily result in shedding of character of an educational institution existing solely for education and then it would become a trading activity. It has been submitted that in order to continue with the character of an educational institution within the meaning of Section 10(23C)(iv) of the Act, the petitioner was required to stop accumulation of excesses by reducing the fees.

5.2 Learned counsel have maintained that diverting the income derived from the society like the petitioner for building capital assets would not be solution to the accumulation of surpluses but it would attract the provisions of the Act providing for payment of tax. It is required to reduce its fees so as to shed its commercial character. It has

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also been submitted that the capital asset even if created for the school building, hostel and other such assets then it would not be considered to be expenditure incurred to advance the object of education as it would be simply creating capital asset which would not qualify to account under 85% of expenditure.

5.3 Learned counsel for the revenue also placed reliance on the judgment of Hon'ble the Supreme Court rendered in the case of **Children Book Trust (supra)** and argued that merely because an institution is imparting education, it cannot assume the character of an educational institution or charitable institution because an element of public benefit or philanthropy has to be present. In the absence of a no profit no loss activity, the institution cannot be regarded as a charitable institution. They have also placed reliance on the judgment of Hon'ble the Supreme Court rendered in the case of **Escorts Ltd. v. Union of India, [1993] 199 ITR 43** and argued that if an assessee incurs expenditure of a capital nature for imparting education he could claim only deduction of the specified percentage of the written down value of the asset under clause 10(2)(vi) and such a deduction could be claimed in five consecutive years of the expenditure he had incurred on the acquisition of asset. It has been emphasised that the judgment of Hon'ble the Supreme Court should not be read like a statute. The ratio has to be culled out by reading the whole judgment. It is not permissible to pick out a word or sentence from the judgment of Hon'ble the Supreme Court which may be completely divorce from the context of the question under consideration by giving it a cloak of complete law declared by the Supreme Court under Article 141 of the Constitution. In support of their submission, reliance has been

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placed on the observations made in the case of **Commissioner of Income-Tax v. Sun Engineering Works P. Ltd., [1992] 198 ITR 297 (at page 320).**

5.4 Learned counsel for the revenue have then placed reliance on the judgments passed by this Court in the cases of **Dr. Maharaj Krishana Kapur Educational Charitable Trust and Management Society v. Union of India and another (CWP No. 2047 of 2009, decided on 10.2.2009, Annexure R/1)** and **The Scientific Educational Advancement Society v. Union of India and another (CWP No. 2052 of 2009, decided on 10.2.2009, Annexure R/2)** and argued that the case of **Children Book Trust (supra)** has been applied in both the cases and the order passed by the Chief Commissioner of Income-tax rejecting the request of the society for grant of exemption under Section 10(23C)(iv) of the Act was upheld.

RELEVANT PROVISIONS

6. After hearing learned counsel for the parties and perusal of the pleadings with their able assistance we find that it would first be necessary to read Section 10(23C) along with its sub-clauses (iiiab), (iiiac), (iiiad), (iv) and (vi) of the Act, which are reproduced as under:-

> "10. 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-
>
> (1) to (22) xxx xxx xxx
>
> (23) Omitted by the Finance Act, 2002, w.e.f. 1.4.2003
>
> (23A) xxx xxx xxx

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(23B) xxx xxx xxx

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

(i) to (iiia) xxx xxx xxx

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

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

(iiiad) any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed; *[See Rule 2BC prescribing the limit of rupees one crore]* or

(iiiae) xxx xxx xxx

(iv) any other fund or institution established for

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

(v) xxx xxx xxx

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

6.1 A perusal of the aforesaid provisions would show that if any income is received by a person on behalf of any university or other educational institution existing solely for educational purposes and not for purposes of profit, which is wholly or substantially financed by the Government then it would qualify for exemption as per Section 10(23C) (iiiab) of the Act. Likewise, if such an institution has annual receipt not exceeding the amount of Rs. 1 crore as prescribed by Rule 2BC then it would also be eligible for exemption irrespective of the fact whether it is wholly or substantially financed by the Government as has been laid down in Section 10(23C)(iiiad). However, sub-clause (vi) of sub-section (23C) of Section 10 contemplates that any university or educational institution which has annual receipt exceeding Rs. 1 crore are required to be approved by the prescribed authority like the Chief Commissioner or Director General for the purposes of obtaining exemption from the

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payment of income-tax.

6.2 In the new dispensation made effective from 1.4.1999, monitoring provisions have been incorporated by inserting numerous provisos. The procedure for obtaining exemption has been prescribed by various provisos which postulate filing of an application by a university or other educational institution in the prescribed form and manner. The prescribed authority is to then approve such a university or other educational institution and in that regard may call for such documents including audited annual accounts to satisfy itself about the genuineness of the activities of such university or other educational institution. According to un-numbered third proviso of sub-section (23C) of Section 10 of the Act if a university or other educational institution has applied its income or has accumulated the same for application wholly and exclusively to the object for which it is established then it is to qualify for grant of exemption. However, in case more than 15% of the income is accumulated on or after 1.4.2002 and the period of accumulation of the amount exceeding 15% of its income has not exceeded five years then also it would qualify. The exemption could be granted for a period not exceeding three assessment years. All the un-numbered provisos of Section 10(23C)(vi) of the Act are set out below for facility of reference:

> " **Provided** 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 (via) shall make an application in the prescribed form and manner to the prescribed authority for the purpose of grant of the

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exemption, or continuance thereof, under sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via): *[un-numbered first proviso]*

Provided further that the prescribed authority, before approving any fund or trust or institution or any university or other educational institution or any hospital or other medical institution, under sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via), may call for such documents (including audited annual accounts) or information from the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, as the case may be, as it thinks necessary in order to satisfy itself about the genuineness of the activities of such fund or trust or institution or any university or other educational institution or any hospital or other medical institution, as the case may be, and the prescribed authority may also make such inquiries as it deems necessary in this behalf: *[un-numbered second proviso]*

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 (via) -

(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,

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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;

(ia) 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

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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 (ia), 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: *[un-numbered third proviso]*

Provided also that the exemption under sub-clause (iv) or sub-clause (v) shall not be denied in relation to any funds invested or deposited before the 1st day of April, 1989, otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11 if such funds do not continue to remain so invested or deposited after the 30th day of March, 1993: *[un-numbered fourth proviso]*

Provided also that the exemption under sub-clause

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(vi) or sub-clause (via) shall not be denied in relation to any funds invested or deposited before the 1st day of June, 1998, otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11 if such funds do not continue to remain so invested or deposited after the 30th day of March, 2001: *[un-numbered fifth proviso]*

Provided also that the exemption under sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) shall not be denied in relation to voluntary contribution, other than voluntary contribution in cash or voluntary contribution of the nature referred to in clause (b) of the third proviso to this sub-clause, subject to the condition that such voluntary contribution is not held by the trust or institution or any university or other educational institution or any hospital or other medical institution, otherwise than in any one or more of the forms or modes specified in sub-section (5) of section 11, after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st day of March, 1992, whichever is later: *[un-numbered sixth proviso]*

Provided also that nothing contained in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) shall apply in relation to any income of the fund or trust or institution or any university or other educational institution or any hospital or other medical institution, being profits and gains of business, unless the business is incidental to the

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attainment of its objectives and separate books of account are maintained by it in respect of such business: *[un-numbered seventh proviso]*

Provided also that any notification issued by the Central Government under sub-clause (iv) or sub-clause (v), before the date on which the Taxation Laws (Amendment) Bill, 2006 receives the assent of the President, shall, at any one time, have effect for such assessment year or years, not exceeding three assessment years (including an assessment year or years commencing before the date on which such notification is issued) as may be specified in the notification: *[un-numbered eighth proviso]*

Provided also that where an application under the first proviso is made on or after the date on which the Taxation Laws (Amendment) Bill, 2006 receives the assent of the President, every notification under sub-clause (iv) or sub-clause (v) shall be issued or approval under sub-clause (iv) or sub-clause (v) or] sub-clause (vi) or sub-clause (via) shall be granted or an order rejecting the application shall be passed within the period of twelve months from the end of the month in which such application was received: *[un-numbered ninth proviso]*

Provided also that where the total income, of 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 (via), without giving effect to the

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provisions of the said sub-clauses, exceeds the maximum amount which is not chargeable to tax in any previous year, such trust or institution or any university or other educational institution or any hospital or other medical institution shall get its accounts audited in respect of that year by an accountant as defined in the Explanation below sub-section (2) of section 288 and furnish along with the return of income for the relevant assessment year, the report of such audit in the prescribed form duly signed and verified by such accountant and setting forth such particulars as may be prescribed: *[un-numbered tenth proviso]*

Provided also that any amount of donation received by the fund or institution in terms of clause (d) of sub-section (2) of section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, or which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of sub-section (5C) of section 80G and not transferred to the Prime Ministers National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax: *[un-numbered eleventh proviso]*

Provided also that where the fund or trust or institution or any university or other educational institution

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or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) does not apply its income during the year of receipt and accumulates it, any payment or credit out of such accumulation to any trust or institution registered under section 12AA or to any 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 (via) shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or other medical institution, as the case may be, is established: *[un-numbered twelfth proviso]*

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 is approved by the prescribed authority, as the case may be, 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 (via), 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

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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: *[un-numbered thirteenth proviso]*

Provided also that in case the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in the first proviso makes an application on or after the 1st day of June, 2006 for the purposes of grant of exemption or

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continuance thereof, such application shall be made at any time during the financial year immediately preceding the assessment year from which the exemption is sought: *[un-numbered fourteenth proviso]*

Provided also that any anonymous donation referred to in section 115BBC on which tax is payable in accordance with the provisions of the said section shall be included in the total income: *[un-numbered fifteenth proviso]*

Provided also that all pending applications, on which no notification has been issued under sub-clause (iv) or sub-clause (v) before the 1st day of June, 2007, shall stand transferred on that day to the prescribed authority and the prescribed authority may proceed with such applications under those sub-clauses from the stage at which they were on that day; *[un-numbered sixteenth proviso]*"

6.3 Before discussing the effect of provisos, which have been inserted by the new dispensation, it is significant to refer and examine Section 10(22) vis-à-vis Section 10(23C)(vi), which have been held to be analogues to each other. The scope of section 10(22) of the Act, which is precursor of Section 10(23C)(vi), has been analysed by their Lordships' of Hon'ble the Supreme Court in the case of **American Hotel and Lodging Association Educational Institute (supra)**, holding that the actual existence of the educational institution has been a pre-condition of the application for initial approval under Section 10(22). It has been held that on grant of approval the charging Section 11 and 13 were not to apply. Therefore, before new dispensation, which has been applied from

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1.4.1999, after the grant of exemption under Section 10(22), there was no room for assessment nor any scope for raising any demand, the grant of approval under Section 10(22) used to have an automatic effect. The view of their Lordships' is discernible from the following part of paras 26 and 27, which reads thus:-

> 26. ……Once an applicant-institution came within the phrase "exists solely for educational purposes and not for profit" no other conditions like application of income were required to be complied with. The Prescribed Authority was only required to examine the nature, activities and genuineness of the Institution. The above phrase was the only requirement for initial approval. The mere existence of profit/surplus did not disqualify the institution if the sole purpose of its existence was not profit-making but educational activities as Section 10(22) by its very nature contemplated income of such institution to be exempted. Under Section 10(22) the test was restricted to the character of the recipient of income, viz, whether it had the character of educational institution in India, its character outside India was irrelevant for deciding whether its income would be exempt under Section 10(22).
>
> 27. The moot question in Section 10(22) was - whether the activities of the applicant came within the definition of "income of educational institution". Under Section 10(22) one had to closely analyse the activities of the Institute, the objects of the Institute and its source of income and its utiliza-

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tion. Even if one of the objects enabled the Institute to undertake commercial activity, the institute would not be entitled to approval under Section 10(22). The said section *inter alia* excludes the income of the educational institute from the Total Income."

6.4 A 5-Judge Constitution Bench in the case of **CIT (Addl.) v. Surat Art Silk Cloth Manufacturers Association, [1980] 121 ITR 1 (SC)**, has held that the test of pre-dominant object of the activity is to be seen whether an institution exists solely for education and not to earn profit. Likewise, in **Aditanar Educational Institution's case (supra)** the test laid down is to find out the nature of activity. Therefore, the character of the recipient of income must have the character of educational institution, to be ascertained from the nature of the activities. The law in respect of the aforesaid test even after the new dispensation from 1.4.1999 continues to be the same as it was under Section 10(22) of the Act. The aforesaid view has been expressed by their Lordships' of Hon'ble the Supreme Court in the case of **American Hotel and Lodging Association (supra)** by observing that '*the judgment of this Court as applicable to Section 10(22) would equally apply to Section 10(23C)(vi). The problem arises with the insertion of the provisos to Section 10(23C)(vi)*.' It is, therefore, evident that as long as an institution exists solely for educational purposes then it would qualify for grant of exemption under Section 10(23C)(vi) of the Act.

6.5 We have prefaced the discussion on provisos with the object of putting the real controversy in its true perspective. The orders passed by the Chief Commissioner are identical in all these cases and after hear-

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ing the learned counsel for the parties we are of the view that the following substantive questions of law would arise for determination of this Court:

(A) Whether an educational institution would cease to exist 'solely' for educational purposes and not for purposes of profit merely because it has generated surplus income over a period of 4/5 years after meeting its expenditure?

(B) Whether the amount spent on acquiring/ constructing capital assets wholly and exclusively becomes part of the total income or it becomes entitled to exemption under Section 10(23C)(vi) of the Act?

(C) Whether an institution registered as a Society under the Societies Registration Act, 1860, lose its character as an educational institution, eligible to apply for exemption under Section 10(23C)(vi) of the Act?

RE: QUESTION (A):

7.1 In the preceding paras it has already been noticed by referring to the views of Hon'ble the Supreme Court in the cases of **Aditanar Educational Institution's case (supra)** and **American Hotel and Lodging Association (supra)** that the character of the recipient of income must be that of an educational institution which is to be ascertained from the nature of its activities. In the case of **American Hotel and Lodging Association (supra)**, Hon'ble the Supreme Court has considered the scope of inquiry by the prescribed authority under Section 10(23C)(vi) read with un-numbered third proviso of the Act. In that case the Assess-

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ing Officer during the assessment proceedings had accepted that excess income over and above the expenditure shown in its accounts was not to be taken as assessee's income. When the matter traveled to the CBDT it was held that there is a surplus income, which has been repatriated outside India. Therefore, the assessee did not apply for its income for the purpose of education in India. The view of the CBDT was accepted by the Delhi High Court by dismissing the writ petition filed by the assessee, which is reported as **American Hotel and Lodging Association Educational Institute v. CBDT, [2007] 289 ITR 46 (Delhi)**. The Division Bench of Delhi High Court held that the gross receipt collected by the assessee's branch office in India is income chargeable to tax. It was further held that such income was required to be applied for educational purposes in India and on its repatriation outside India, the assessee lost the entitlement to seek exemption. It was in the aforesaid background that Hon'ble the Supreme Court analysed various provisos added w.e.f. 1.4.1999 and proceeded to observe that '*with the insertion of the provisos to Section 10 (23C)(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 prescribed authority, in terms of Section 10(23C)(vi) by making an application in the standardized form as mentioned in the first proviso to that section*'. Hon'ble the Supreme Court then proceeded to examine various provisos by observing as under:-

> "……With the insertion of the first proviso, the PA is required to vet the application. This vetting process is stipulated by the second proviso. It is important to note that the

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second proviso also indicates the powers and duties of the prescribed authority. While considering the approval application in the second proviso, the prescribed authority is empowered before giving approval to call for such documents including annual accounts or information from the applicant to check the genuineness of the activities of the applicant institution. Earlier that power was not there with the prescribed authority. Under the third proviso, the prescribed authority has to ascertain while judging the genuineness of the activities of the applicant institution as to whether the applicant applies its income wholly and exclusively to the objects for which it is constituted/established. Under the twelfth proviso, the prescribed authority 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 12AA 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 prescribed authority 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

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that proviso, the circumstances are given under which the prescribed authority is empowered to withdraw the approval earlier granted. Under that proviso, if the prescribed authority 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 prescribed authority is empowered to withdraw the approval earlier granted after complying with the procedure mentioned therein."

7.2 From the aforesaid view expressed by Hon'ble the Supreme Court it is evident that at the initial stage when the application for exemption is filed by an educational institution the scope of inquiry is restricted only to ascertain the genuineness of the activities of such an institution. Such an inquiry as per the proviso may even extend to the examination of accounts of the institution, application of its income to the object and purposes of education and other cognate aspects as has been indicated in the observation made by their Lordships'. Once on the basis of genuineness of the activities of an educational institution approval is granted for exemption then the monitoring provisions would come in play and the Assessing Officer has to examine whether the conditions on which the exemption was given, have been fulfilled or not. The aforesaid opinion is

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also supported by the speech of the Finance Minister as reported in [1998] 232 ITR 13 (ST).

7.3 Hon'ble the Supreme Court in para 32 of the judgment rendered in **American Hotel and Lodging Association (supra)** has further held that there is difference between stipulation of conditions and compliance therein. It has been held that the threshold conditions are aimed at discovering the actual existence of an educational institution and approval of the prescribed authority for which an application in the standardized form in terms of the first proviso has to be given by every applicant. If the pre-requisite condition of actual existence of the educational institution is fulfilled then the question of compliance with the requirements contemplated by various provisos would arise. Hon'ble the Supreme Court has approved the contention that the un-numbered 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. It follows that firstly the application is filed in the standardized form in accordance with the un-numbered first proviso and then approval is granted. If the educational institution actually exists for education purposes alone then the educational institution is permitted to operate subject to monitoring conditions. A workable solution has been provided by Hon'ble the Supreme Court in para 33 by observing as under:-

> "33. To make the section with the proviso workable we are of the view that the monitoring conditions in the third proviso like application/utilization of income, pattern of invest-

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ments to be made etc. could be stipulated as conditions by the prescribed authority subject to which approval could be granted. For example, in marginal cases like the present case, where appellant-Institute was given exemption up to financial year ending 31.3.1998 (assessment year 1998-99) and where an application is made on 7.4.1999, within seven days of the new dispensation coming into force, the prescribed authority can grant approval subject to such terms and conditions as it deems fit provided they are not in conflict with the provisions of the 1961 Act (including the abovementioned monitoring conditions). While imposing stipulations subject to which approval is granted, the prescribed authority may insist on certain percentage of accounting Income to be utilized/applied for imparting education in India. ……. Therefore, cases where earlier the applicant has obtained exemption(s), as in this case, need not be re-opened on the ground that the third proviso has not been complied with. However, after grant of approval, if it is brought to the notice of the prescribed authority that conditions on which approval was given are breached or that circumstances mentioned in the thirteenth proviso exists then the prescribed authority can withdraw the approval earlier given by following the procedure mentioned in that proviso. The view we have taken, namely, that the prescribed authority can stipulate conditions subject to which approval may be granted finds support from sub-clause (ii)(B) in the thirteenth proviso."

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7.4 The question then is whether accumulation of income year after year extending over 4/5 years would deprive an educational institution existing solely for education purpose, its character as an educational institution solely for education purpose and not for profit. In the 5-Judge Constitution Bench judgment rendered in the case of **Surat Art Silk Cloth Manufacturers Association (supra)**, the question of interpretation of clause 15 of Section 2 of the Act was involved. The words 'not involving the carrying on any activity for profit' occurring at the end of the definition of 'charitable purpose' in the aforesaid provision were interpreted. After analyzing various judgments and the speech of the Finance Minister, it has been held as under:-

> "……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.

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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, Lok Sikshana trust case* [1975] 101 ITR 234, 256 (SC) 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 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." (emphasis added. Italics in original)

7.5 The Constitution Bench then proceeded to illustrate the application of the aforesaid test by citing the examples of monthly journal of Gandhi Peace Foundation and the counter example of sale of blood by a Blood Bank on payment of higher price. The aforesaid view has been cited with approval by Hon'ble the Supreme Court in the case of **American Hotel and Lodging Association (supra)**, which reads thus:-

> "28. In Addl. CIT v. Surat Art Silk Cloth Manufacturers Association reported in [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

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> 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 realization 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 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." (emphasis added)

7.6 It is further appropriate to point out that Rule 2BC of the Rules has prescribed the limit of Rs. 1 crore where the requirement of seeking approval for exemption would not be applicable. If the turn over is more than Rs. 1 crore then exemption in terms of Section 10(23C)(vi) is required. The un-numbered third proviso postulates the investment and deposits of surplus funds. An educational institution could make deposits and can also earn interest, which is permissible. There are certain limits imposed on the accumulations which of course have to be met. A Division Bench of Delhi High Court in the case of **Director of Income-Tax (Exemption) v. Eternal Science of Man's Society, [2007] 290 ITR 535 (Delhi)**, has held as under:-

> "It may also be mentioned that for seeking the exemption under Section 10(23C), the assessee will have to follow the guidelines mentioned in Form No. 56D (Rule 2CA). One of the conditions in Form 56-D is that assessee will have to sub-

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mit the audited accounts and balance sheets for the last three years along with a note on the examination of accounts and on the activities as reflected in the accounts and in the annual reports with special reference to the appropriation of income towards objects of the university or other educational institution. From the audited accounts, one can easily see whether the funds were utilised for the expansion of educational institution/activity or for personal profits. In the present case, the opposite-parties have not brought any material on record to prove that the surplus earned by the assessee petitioner was utilised for personal profit/gain on anyone including the Founder-Manager/Director. Whatever fund was acquired, the same was utilised for the expansion of educational activities of institution. Initially there were five students and now the institution is imparting education to more than 34,000 students as pointed out during the course of arguments. Thus, the assessee is fully satisfying all the statutory requirements for getting exemption under Section 10(23C)(vi) of the Income Tax Act. Apart from it, it may be mentioned that the Hon'ble Supreme Court has observed in the case of CIT v. Surat Art Silk Cloth Manufacturers Association, 121 ITR SC, p.1 that the institution must be for general public utility and certainly not for profit, then it can be treated as charitable institution. In the instant case, no adverse material was brought on record by the opposite-parties to reject the application dated 4.2.1999 for seeking said exemption."

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7.7 The aforesaid view has been adopted, applied and followed by a Division Bench of Allahabad High Court in the case of **City Montessori School (supra)**, as has been rightly contended by the learned counsel for the petitioner(s). Even Special Leave Petition against the aforesaid judgment has been dismissed. Accordingly, the question of law has to be answered in favour of the assessee and against the revenue.

RE: QUESTIONS (B) & (C):

8.1 We are further of the view that capital expenditure has to be deducted from the gross income of the educational institution like the petitioner-society and the Chief Commissioner has committed grave error in law by refusing to do so. The view of the Chief Commissioner is contrary to the third proviso to Section 10(23C) of the Act.

8.2 The methodology adopted by the Chief Commissioner of Income Tax, while computing surplus by not deducting the capital expenditure incurred by the petitioner-society from the gross income is contrary to the un-numbered third proviso to section 10(23C)(vi) of the Act. The words '*not for the purposes of profit*' accompanying the words '*existing solely for educational purposes*' has to be read and interpreted in view of third proviso to Section 10(23C), which prescribes the methodology for the utilization and accumulation of income at the hands of the educational institutions by imposing two restriction, namely, (i) that accumulation of surplus upto 15% can be for any number of years by the educational institution for which purposes it is established; and (ii) if the accumulation is more than 15% of the income the same can be accumulated for a maximum period of 5 years to be utilized for achieving the objects of the society. The inevitable consequence is that 85% of the

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income has to be applied for its objects by the petitioners. On a true and proper interpretation of the provisions of Section 10(23C)(vi) read with the third proviso thereof, the capital expenditure, if incurred by the petitioner-society for the attainment of the objects of the society, has to be deducted from its gross receipts/income. This is so because the third proviso contains the expression '*applies its income, or accumulates it for application or, wholly and exclusively to the objects for which it is established*'. The word '*wholly*' refers to the quantum of expenditure and the word '*exclusively*' refers to the motive, object or the purpose of expenditure. [see Siddho Mal & Sons v. CIT, (1980) 3 Taxman 1 (Delhi); C.J. Patel and Co. v. CIT, [1986] 158 ITR 486 (Guj); and Mysore Kirloskar Ltd. v. CIT, (1987) 30 Taxmann 467 (Kar)].

8.3 Even otherwise, unlike the provisions of Section 37 and 36 (1)(xii) of the Act, where the legislature has used the words '*not being in the nature of capital expenditure*', which words do not find place in the third proviso preceding the words '*wholly and exclusively*', clearly demonstrate that in case of an educational institution, capital expenditure is to be deducted, whenever the institution like the petitioner-society applies its income for the achievement of its object. The word '*applies its income*' means '*to put to use*' or '*to turn to use*' or '*to make use*' or '*to put to practical use*' (see CIT v. Shri Plot Swetamber Murti Pujak Jain Mandal, 211 ITR 293 (Guj)]. The aforesaid view is further supported from a bare perusal of clause 11 of Form No. 56D of the Rules, which is required to be filed in terms of the provisions of Rule 2CA when viewed in the light of the judgment rendered by Hon'ble the Supreme Court and the High Court of Delhi in the cases of **S.R.M.M. CT. M. Tiruppani**

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Trust v. CIT, [1998] 230 ITR 636 and **CIT v. Divine Light Mission, (2005) 196 CTR 135 (Del)** respectively. In clause 11 of Form 56D of the Rules it is mentioned that the amount of income of an university or other educational institution that has been or deemed to have been utilized wholly and exclusively for its objects shall have the meaning assigned to it in sub-sections (1) and (1A) of Section 11. Hon'ble the Supreme Court and the Delhi High Court in the aforementioned cases, arising under Section 11(1) of the Act, have held that the capital expenditure incurred by the trust would be application of income and the assessee would be entitled to exemption under Section 11(1) of the Act. Even the High Court of Uttrakhand in the case of **CIT v. Jyoti Prabha Society, (2009) 177 Taxman 429 (Uttrakhand)** has held that the educational society which had utilized rental income again for the purposes of imparting education by maintaining the buildings and constructing new building for the same purpose, would be entitled to the exemption claimed under Section 11 of the Act. Section 11(1)(a) is *pari materia* to the third proviso to Section 10(23C)(vi) of the Act and the only difference is with regard to the percentage of income and the period for which it can be carried forward. Yet again the judgment rendered by the High Court of Calcutta in the case of **Birla Vidya Vihar Trust v. CIT, (1981) 7 Taxman 391,** deserves to be taken note of wherein noticing the Circular dated 19.6.1968 it has been emphasized that capital expenditure has to be deducted from the total income of the Trust for the purposes of finding out how much has been accumulated by the assessee-Trust. Thus, both on principle and precedents the capital expenditure is to be deducted from the gross income of the educational institutions like the petitioner-

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society. Admittedly, in the present case of the petitioner-society the application of income is more than 100% for the attainment and achievement of its objects in the last three years, a fact not disputed by the Chief Commissioner of Income Tax. The petitioner-society, when admittedly having utilized more than 100% of the income for achieving its objects, could by no stretch of imagination be held to be an educational institution existing for the purposes of making profit so as to be not entitled to exemption in view of the provisions of Section 10(23C) (vi) of the Act. The Chief Commissioner failed to keep in view the third proviso while wrongly holding that since the substantial profits are being earned year after year it could not be said that the surplus is arising incidentally and, therefore, the petitioner-society was not entitled to be exemption.

8.4 We also find substance in the argument raised by the learned counsel for the petitioner that the judgment rendered in **Children Book Trust's case (supra)** has no application to the cases under Section 10 (23C)(iv) of the Act primarily for the reason that the provisions under which the aforesaid judgment was rendered by Hon'ble the Supreme Court are not *pari materia* to the provisions relating to exemption, namely, Section 10(23C) of the Act apart from the scheme of the Act being totally different. The order passed by the Chief Commissioner when tested in the light of the judgment rendered in the case of **Children Book Trust(supra)**, the said order would be bad in law in view of the finding recorded in para 75 of the judgment that if education is imparted with profit motive the purpose is lost. In the case in hand the motive is not to make profit inasmuch as the requirement of the third proviso to

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Section 10(23C)(vi) of the Act is met and/or fulfilled by the petitioner-society on account of the fact that more than 85% of its income is utilized for the attainment of the objects of the society either in form of capital or revenue expenditure. The judgment rendered by Hon'ble the Supreme Court in the case of **Children Book Trust (supra)** cannot be applied to the cases arising under the provisions of Section 10(23C)(vi) of the Act in view of the statutory obligation cast on the educational institutions to spend 85% of its total income earned during the financial year for pursing its objects and the express monitoring conditions provided for by the legislature upon the fulfillment of which even if there remains a surplus at the hands of the educational institutions, it would be entitled to exemption provided the educational institution solely exists for educational purposes.

8.5 The observations of Hon'ble the Supreme Court quoted from para 82 of the aforesaid judgment to the effect that – "*what we want to stress is where a society or body is making systematic profits, even though that profit is utilized only for Charitable purposes, yet it cannot be said that it could claim exemption*" deserves to be read in conjunction with the express provisions of the third proviso to Section 10(23C)(vi) of the Act which stipulate the retention of 15% of the profits of the total income after quantification therefore, of the educational institution earned in each year provided 85% of the total income is spent for the objects of the society. In fact, the judgment rendered by Hon'ble the Supreme Court in **Children Book Trust Case (supra)** on the facts and in the circumstances of the case of the petitioner-society herein, is not at all applicable by virtue of the applicability of the mechanism contained in

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the third proviso to Section 10(23C)(vi) of the Act. It may be clarified that Hon'ble the Supreme Court had decided the case of **Children Book Trust (supra)** under the Delhi Municipal Corporation Act, 1957, and had not dealt with the provisions of Section 10(23C)(vi) of the Act, which are a complete code in itself, inter alia, providing a mechanism for the utilization of surpluses and prior to the utilization determination of the existence of the educational institution solely for educational purposes and not for making profit. The determination of the existence of educational institution solely for educational purposes is required to be done on the basis of its objects including the utilization of its income in accordance with the conditions laid down in the third proviso to section 10(23C)(vi) of the Act. Merely because there are surpluses in the hands of the educational institution would not *ipso facto* lead to an inevitable conclusion that such an educational institution is existing for making profits and not solely for educational purposes. Therefore, the interpretation put forth by the Chief Commissioner that there has to be a reasonable profit only and then only an institution can be said to be not existing solely for the purposes of profit, is totally a misconception of law. There is a definite purpose behind the allowing of setting up educational institutions at the hands of private entrepreneurs including Trusts/Societies by the Government. Various other educational colleges like Engineering and Pharmacy etc. could not have been established for want of funds. The Government with a definite idea and object purportedly opened this area of education for the private sector. The Government, who is lacking funds appears to have thought that private sector could do this job very well. Once the very intention of the

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Government, is to promote education in the private sector such an action like that of the Chief Commissioner would seriously discourage those activities and the avowed object could never be achieved.

8.6 It is further pertinent to notice the judgment of Hon'ble the Supreme Court in the case of **TMA Pai Foundation v. State of Karnataka, (2002) 8 SCC 481**. The 11-Judge Constitution Bench has held that the private educational institutions are bound to generate funds for betterment and growth of the institutions and for which there may be a surpluses for furtherance of education. Therefore, it is not only permissible but an important requirement to run the institutions of such a strength. Further, in **Aditanar Educational Institution (supra)**, Hon'ble the Supreme Court has observed that when surplus is utilized for educational purposes i.e. for infrastructure development, it cannot be said that the institution was having the object to make profit. Hon'ble the Supreme Court has rightly observed time and again that surpluses used for management and betterment of the institutions could not be termed as profit. If the stand of the Department/Revenue is accepted to be correct, especially in the wake of the methodology adopted by the Chief Commissioner in ascertaining profits, then no educational institution like the petitioner-society could be said to be existing solely for educational purposes as in every case of an educational institution there is bound to be a profit. The provision of Section 10(23C)(vi) would be rendered otiose if the interpretation adopted by the Chief Commissioner is accepted and the manner in which exemption validly granted to the petitioner-society has been withdrawn. The approach of the Chief Commissioner is wholly erroneous being contrary to the express

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provisions of the third proviso to Section 10(23C)(vi) for the following reasons - (i) Unlike the provisions of Sections 37 and 36(xii), the incurring of capital expenditure is not expressly excluded in the third proviso; and (ii) Had it been the intention of the legislature to exclude capital expenditure while applying the income of the Trust as per the third proviso to Section 10(23C)(vi) then the said proviso would have contained an express embargo against such exclusion.

8.7 The contention of the revenue for sustaining the validity of the impugned Order on the ground that the petitioner(s) being societies registered under the 1860 Act do not fall within the ambit of the expression '*other educational institutions*' and, therefore, exemption has been rightly withdrawn under Section 10(23C)(iv) of the Act, cannot be accepted because after the notice was issued for withdrawing the exemption on the said ground, reply was filed by the petitioner(s) asserting that in view of the law laid down by various High Courts and Hon'ble the Supreme Court such a ground was not tenable. The Chief Commissioner thereafter did not issue any notice to the assessee making the aforesaid ground as the basis for withdrawal of exemption nor there is any finding recorded in the impugned orders. Thus, the said ground on which there is no finding in the impugned Order is not sustainable in view of the law laid down by Hon'ble the Supreme Court in the case of **Mohinder Singh Gill v. Chief Election Commissioner, AIR 1978 SC 851 (para 8)**. Secondly, such a plea in any case would not sustain the impugned order, inasmuch as, in the case of **Aditanar Educational Institution (supra)** it has been held that –

"……We are of the view that an educational society or a

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trust or other similar body running an education institution solely for educational purposes and not for the purpose of profit could be regarded as "other educational institution" coming within Section 10(22) - See CIT Vs. Doon Foundation (1985) 154 ITR 208 and Aggarwal Shiksha Samiti Trust (1987) 168 ITR 751(Raj). It will be rather unreal and hyper technical to hold that the assessee society is only a financing body and will not come within the scope of "other educational institution" as specified in Section 10(22). The object of the society is to establish, run, manage or assist colleges or schools or other educational institutions solely for educational purposes and in that regard to raise or collect funds, donations, gifts etc. Colleges and schools are media through which the assessee imparts education and effectuates its objects. In substance and reality, the sole purpose for which the assessee has come into existence is to impart education at the levels of colleges and schools and so, such an educational society should be regarded as an "educational institution" coming within Section 10(22). We hold accordingly." (emphasis added)

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 **M/s 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

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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 Uttrakhand High Court runs contrary to the provisions of Section 10(23C)(vi) of the Act including the provisos thereunder. Section 19(23C)(vi) of the Act is equivalent to the provisions of Section 10(22) existing earlier, which were introduced with effect from 1.4.1999 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 1.4.1999 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 & Lodging Association Educational Institute (supra)**.

8.9 Likewise, the reliance of the revenue on the judgments of this Court rendered in the cases of **Dr. Maharaj Krishana Kapur Educational Charitable Trust and Management Society (supra)** and **The Scientific Educational Advancement Society (supra)** would also not be applicable for the reasons that in the case of **Dr. Maharaj Krishna Kapur Educational Charitable Trust and Management**

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Society (supra) the Chief Commissioner has held that the assessee was generating substantial surpluses and the percentage of income applied for educational purposes was less than the limit prescribed under the third proviso of Section 10(23C) (vi) of the Act and, therefore, the assessee was not entitled to the exemption. This Court upheld the order of the Chief Commissioner by holding that since the assessee had not applied 75% of its income for the educational purposes upto assessment year 2001-02 and 85% from the assessment year 2002-03, and the excess accumulation of 15% of income has to be applied for the objects of the society within a period of 5 years, therefore, there was no legal infirmity in the order of the Chief Commissioner. However, in the case of the petitioner-society it has applied more than 85% of its income for educational purposes for the assessment years in question and, therefore, it is totally wrong on the part of the respondents to contend that the writ petition of the petitioner-society deserves to be dismissed in view of the aforesaid judgment rendered by this Court in the case of **Dr. Maharaj Krishna Kapur Educational Charitable Trust and Management Society (supra)**.

8.10 Similarly, in the case of **The Scientific Educational Advancement Society (supra)** the petitioner, which was a school, had sold a piece of land to a private builder who had built flats on that area and had purchased two farmhouses constructed by M/s Ansal Group of Builders who had built the same as residential units. The Chairman of the petitioner in that case had been visiting the farm houses and no permission from any prescribed authority had been obtained for opening any educational institute on the property purchased. Nothing was

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brought on record to show that the petitioner had intended to carry out any educational activity on the said land. It was in this backdrop that this Court upheld the order of the Chief Commissioner, who had refused to grant exception under 10(23C)(vi) of the Act. The factual position is far different in the instant case. The petitioner-society admittedly is running a school solely for educational purposes and not for making profit and, therefore, the judgment relied upon by the respondents rendered by this Court in the case of **The Scientific Educational Advancement Society (supra)** is not remotely applicable to the case of the petitioner-society.

8.11 Reference may also be made to various provisions of un-numbered provisos 13, 14, 15, 16 and 17. These provisions came up for consideration before a Division Bench of Allahabad High Court in the case of **City Montessori School (supra)**. It has been opined by the Division Bench that proviso to Section 10(23C)(vi) permits the investment and deposit of surplus funds. Placing reliance on the judgments of Delhi High Court in the case of **Director of Income-Tax (Exemption) v. Eternal Science of Man's Society, [2007] 290 ITR 535 (Delhi)** and **Director of Income-Tax (Exemption) v. Prakash Education Society, [2006] 286 ITR 288 (Delhi)** the Division Bench of Allahabad High Court has concluded that such an institution could deposit the surplus for earning interest. It has then been opined that for seeking exemption under Section 10(23C) a society will have to follow the guidelines laid down in Form 56D(Rule 2CA). One of the conditions in Form 56D is that an assessee has to submit audited accounts and balance sheets for the last three years along with a note on the exemption for accounts and on the activity as reflected in the accounts. It is also

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required to submit the annual report with special reference to the appropriation of income towards objects of the university or other educational institution. From the audited accounts and other documents required to be submitted by the assessee it could be easily seen whether the funds were utilised for expansion of educational institution/activity or for personal profits. If the funds are utilised for expansion of educational activities of the institution and not for personal profits then it has to be granted exemption.

8.12 In view of the above, both the questions of law have to be answered in favour of the assessee-petitioner(s) and against the revenue.

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 analogues 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

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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, after grant of approval if it comes to the notice of the prescribed authority that the conditions on which approval was given, have been

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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 01.04.2002, 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 **M/s Queens Educational Society (supra)** and the connected matters, is not applicable to cases fall within the provisions 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.

8.14. When the facts of the lead case are examined in the light of

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above discussion, it is evident that capital assets acquired/constructed by the educational institutions have been treated as income in a blanket manner without recording any finding whether the capital assets have been applied and utilised to advance the purpose of education. It is obligatory on the part of the prescribed authority while exercising power under un-numbered thirteenth proviso to consider whether expenditure incurred as capital investment is on the object of education or not. Therefore, the orders impugned in these petitions passed by the prescribed authority are liable to be quashed. It is appropriate to mention that in these cases the impugned orders passed by the Chief Commissioner of Income Tax, Chandigarh and those of by the Chief Commissioner of Income Tax, Ludhiana, are similar in substance and appear to have been inspired by the view taken by the Uttrakhand High Court in the case of **M/s Queens Educational Society (supra),** which we have not accepted.

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) (vi) 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.

(M.M. KUMAR)
JUDGE

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(JASWANT SINGH)
JUDGE

January 29, 2010

Pkapoor

HIGH COURT OF PUNJAB AND HARYANA
सत्यमेव जयते

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Sr.No.Civil Writ Petition No. Parties Name1.3727 of 2009Khalsa College, Lyallpur, Educational Trust v. CCIT and another2.5562 of 2009Gulab Devi Memorial Hospital Trust, Jalandhar v. Central Board of Direct Taxes and others3.5649 of 2009Baba Banda Bahadur Education Trust, Fatehgarh Sahib v. Central Board of Direct Taxes, New Delhi and others4.5978 of 2009Montgomery Guru Nanak Educational Trust, Jalandhar v. CCIT, Ludhiana and another5.6031 of 2009Pine Grove International Charitable Trust v. Union of India and others6.6834 of 2009Sanjay Gandhi Educational Society v. Union of India 7.7030 of 2009St.Peter's Educational Society Chandigarh v. CCIT (NWR), Chandigarh8.7031 of 2009Sant Educational Society v. CCIT (NWR), Chandigarh9.7038 of 2009Saint Soldier Education Society v. Union of India and others10.7042 of 2009Shivalik Educational Society v. CCIT (NWR), Chandigarh11.7065 of 2009Shishu Niketan Model School v. CCIT (NWR), Chandigarh.12.7082 of 2009St. Joseph's Educational and Charitable Trust v. CCIT (NWR), Chandigarh13.7113 of 2009Ingo Global Education Foundation v. Union of India and others14.7346 of 2009Gian Jyoti Educational Society Mohali v. CCIT (NWR), Chandigarh15.7391 of 2009St. Stephen's Educational Society, Chandigarh v. CCIT (NWR), Chandigarh16.7422 of 2009Ryat Educational and Research Trust v. CCIT, NWR, Chandigarh17.7857 of 2009Sh.Raghunath Rai Memorial Education and Charitable Trust v. Union of India and others18.8317 of 2009Smt.Savitri Bhagwan Dass Kaura Education Society Chandigarh v. Union of India and others19.8912 of 2009National education Development Trust v. CCIT (NWR), Chandigarh20.9504 of 2009Sikh Education Society v. Union of India and another21.9777 of 2009Kandi Friends Education Trust v. Union of India and others

(M.M. KUMAR)
JUDGE

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January 29, 2010
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