

Newsflash

Supreme Court : New
Noble Educational
Society : Section 10(23C)
of the Income Tax Act,
1961

October 2022



Supreme Court (SC) – accords literal (narrow) interpretation to the word “solely” appearing under section 10(23C) of the Income tax Act, 1961 (the Act) for educational institutions. Overrules Division Bench rulings in Queens Education Society and American Hotel.



SC in a recent ruling¹ dismisses batch of appeals arising from a judgment of the Andhra Pradesh High Court (HC) that denied the appellant Trusts the benefit of exemption under section 10(23C) of the Act. Key highlights of the ruling are summarized below.

Civil Appeal No. 3795 of 2014 M/s. New Noble Educational Society v. The Chief Commissioner of Income Tax 1 and ANR. with Civil Appeal No. 3793 of 2014; Civil Appeal No. 3794 of 2014; Civil Appeal No. 9108 of 2012; Civil Appeal No. 6418 of 2012

1. Section 10(23C) of the Act provides for tax exemption to charitable trusts, societies or institutions existing “solely” for educational purposes and not for the purposes of profit;
2. The word “solely” was, however, interpreted by two previous Division Bench rulings in 2008 (*American Hotel and Lodging Association*²) and 2015 (*Queen’s Education Society*³) to mean that the test for determination was whether the principal or main activity was education or not, rather than whether some profits were incidentally earned. The SC in those rulings followed the “predominant object” test laid down by the Constitution Bench ruling in *Surat Art Silk*⁴;
3. The three-judge bench of the SC headed by Chief Justice of India Uday Umesh Lalit overruled the previous judgments, declaring that the word “solely” must be accorded a literal interpretation since the intent of the legislature is clear that tax exemption should be granted to only those institutions which impart formal scholastic learning. “Education” has been interpreted to be **essentially in the nature of a “charitable activity”** conducted for upliftment of the society-at-large. The SC, while interpreting the law, relied on the 11-judge bench judgment in the TMA Pai Foundation case of 2002. It noted
 - “Our Constitution reflects a value which equates education with charity. That it is to be treated as neither business, trade, nor commerce, has been declared by one of the most authoritative pronouncements of this court in TMA Pai Foundation (*supra*). The interpretation of education being the ‘sole’ object of every trust or organization which seeks to propagate it, through this decision, accords with the constitutional understanding and, what is more, maintains its pristine and unsullied nature (para # 77).
 - In a knowledge based, information driven society, true wealth is education – and access to it. Every social order accommodates, and even cherishes, charitable endeavour, since it is impelled by the desire to give back, what one has taken or benefitted from society” (para # 77).

¹Civil Appeal No. 3795 of 2014 M/s. New Noble Educational Society v. The Chief Commissioner of Income Tax 1 and ANR. with Civil Appeal No. 3793 of 2014; Civil Appeal No. 3794 of 2014; Civil Appeal No. 9108 of 2012; Civil Appeal No. 6418 of 2012

²American Hotel and Lodging Association v CBDT [2008] 10 SCC 509

³Queen’s Education Society v Commissioner of Income Tax [2015] 8 SCC 47

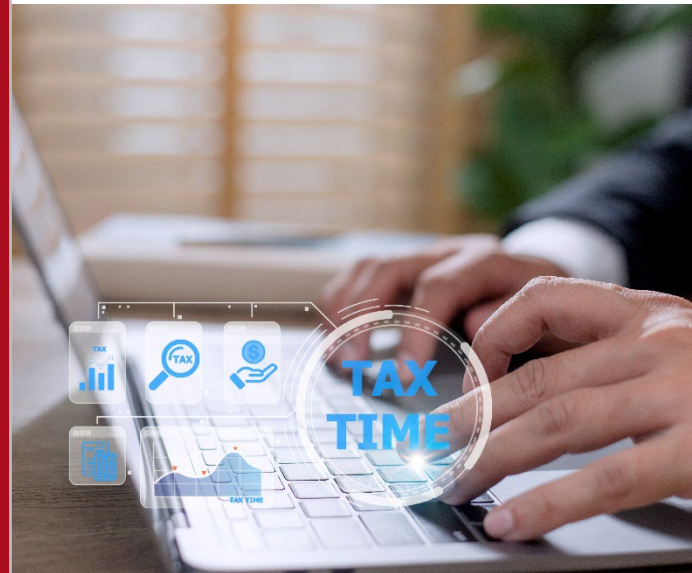
⁴Additional Commissioner of Income Tax v Surat Art Silk Cloth Manufacturers’ Association, (1980) 2 SCC 31

4. The apex court further called education as the key that unlocks the golden door to freedom. In the words of SC - "Education ennobles the mind and refines the sensibilities of every human being. It aims to train individuals to make the right choices. Its primary purpose is to liberate human beings from the thrall of habits and preconceived attitudes. It should be used to promote humanity and universal brotherhood. By removing the darkness of ignorance, education helps us discern between right and wrong. There is scarcely any generation that has not extolled the virtues of education, and sought to increase knowledge" (para # 32)
5. SC holds that the education institutions shall "solely" engage in education or educational activities, and not engage in any activity of profit, means that such institutions 'cannot' have objects which are unrelated to education;
6. For claiming/maintaining eligibility under section 10(23C) of the, it would be incumbent upon the concerned educational society/ institution to discharge onus **to prove that its WHOLE & SOLE objective** is to impart education and conduct education-related activities. In the words of SC - "*In the opinion of this court, a trust, university, or other institution imparting education, as the case may be, should necessarily have all its objects aimed at imparting or facilitating education. Having regard to the plain and unambiguous terms of the statute and the substantive provisions which deal with exemption, there cannot be any other interpretation*" (para #51)
7. "Incidental" income earned by a particular educational society/ institution is permissible *provided* separate books-of-account are maintained;
8. *Ordinarily*, focus of enquiry has to remain on the "nature of income" (viz. being *incidental* in nature to the "sole"/ "exclusive" object of imparting education), and not on the quantum of surplus/ profits so generated. The SC has used the expression (Para # 63) "*.....disproportionate weight ought not to be given to surpluses or profits, provided they are incidental.*";
9. Accordingly, profits generated from sale of textbooks, providing transportation facilities, running hostel facilities, etc. are to be regarded as being incidental to the "sole" objective of propagating the cause-of-education;
10. For example (Para# 73), profits generated from leasing/ letting-out of school infrastructure/ facilities to other trusts, societies, etc. is NOT to be considered as being "incidental" to the cause-of-education. Such income clearly has a commercial-leaning, and it departs from the "sole" objective of imparting the noble cause of education - which may consequentially result in denial of exemption u/s 10(23C) of the Act;
11. The SC held that the claim for approval or registration will have to be considered in the light of subsequent events, if any, disclosed in fresh applications made by the appellants in that regard. The SC has categorically mentioned that since the present judgment has departed from the previous ruling(s) regarding the meaning of the term "solely", in order to avoid disruption, and to give time to make appropriate changes and adjustments, it would be in the larger interests of the Society that the current ruling operates prospectively.

Nangia Andersen LLP's Take

This a landmark ruling and taxpayers wait to see as to how the tax department interprets it and proceeds with it at the field-level. The SC, in our view, has explicitly allowed leeway to educational institutions/ societies likely to be affected by the current dictum to make *"....appropriate changes and adjustments"* - essentially to align their objectives/ functioning with the *new definition* of "solely" - as expounded by the Hon'ble Bench.

Accordingly, while there may be an endeavour to impose the new definition to historical cases, but that would not, in our view, withstand legal scrutiny - owing to the clear mention under Para #78 to the effect that - *in order to avoid disruption*, the 'newly-established law' shall operate *prospectively*.





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