

# TAX FLASH NEWS

4 November 2022

## The Supreme Court, while dealing with exemption relating to charitable institutions, interprets 'General Public Utility' and discards the 'Predominant Object' test

### Executive Summary

Recently, the Supreme Court, in a batch of appeals<sup>1</sup> dealt with the interpretation of the scope of 'General Public Utility' (GPU) for claiming tax exemption for charitable institutions. The Supreme Court dealt with the aspect of the availability of tax exemption to charitable institutions in the GPU category in the context of their carrying on activities in the nature of trade, commerce, or business for consideration.

This case involves multiple charitable institutions ranging from ICAI, cricket associations, statutory authorities notified under Section 10(46), trade promotion bodies, non-statutory bodies like ERNET, NIXI, GS1 India, and private trusts. The Supreme Court has discarded the predominant object test laid down by Surat Silk Mills<sup>2</sup> while granting charitable status under the GPU category.

The Supreme Court held that a taxpayer claiming tax exemption under the GPU category cannot undertake any trade, commerce, or business, or provide service in relation thereto for any consideration, i.e., cess, fee, or any other consideration, unless such activities are conducted in the course of achieving the object of GPU, and it does not violate the specified threshold<sup>3</sup> prescribed under the Act.

The Supreme Court observed that Section 11(4A) should be interpreted in line with Section 2(15) and the activity in the nature of trade, commerce or business, or service in relation to such activities, should be conducted in the course of achieving the object of GPU, for it to be considered as incidental and the income therefrom must be less than the specified threshold.

It has been clarified that the revenue must scrutinize the record annually to discern whether the nature of the taxpayer's activities amounts to 'trade, commerce or business' based on its income (i.e., whether the amounts charged are on cost-basis or significantly higher) and examine the prescribed threshold limits have not been breached.

### Background

- Several charitable institutions and private trusts were denied charitable status by the tax department, holding that the carrying on of any trade, commerce, or business is per se barred for a GPU category charitable institute, precluding its tax-exempt status under the Act.
- Various High Courts had interpreted the amended provision and had held that carrying on a trade, commerce, or business in itself is not a disqualification for GPU category charitable institutions and allowed the taxpayers' claim for exemption.
- These High Court decisions were challenged by tax authorities before the Supreme Court, mainly on the ground that the institutions were carrying on business activities which do not qualify as GPU under the amended provision.

<sup>1</sup> The Supreme Court dealt with a batch of appeals with a lead case, namely 'ACIT (Exemptions) v. Ahmedabad Urban Development Authority', Civil Appeal no. 21762 of 2017 – Taxsutra.com

<sup>2</sup> ACIT v. Surat Art Silk Cloth Manufacturers Association [1978] 121 ITR 1 (SC)

<sup>3</sup> The aggregate receipts from such activities do not exceed 20 per cent of the total receipts of the trust

## Supreme Court's decision

**Current position, i.e. after amendments introduced by the Finance Act, 2008 (with effect from the assessment year 2009-10) and subsequent amendments to Section 2(15):**

- The inclusion of the term 'in the nature of' in the proviso to Section 2(15) was to clarify that not only trade, commerce, or business but all activities resembling them or services in relation to such activities were prohibited.
- After amendments introduced by the Finance Act, 2008, a GPU category charitable institution cannot engage in any activity in the nature of trade, commerce, business, or any service in relation to such activities for any consideration. However, such restriction of carrying on a business activity does not apply to other limbs of charitable purposes such as relief to the poor, education, medical relief, etc.
- The prohibition is relieved to a limited extent if two conditions are satisfied, i.e., (i) activities in the nature of trade, commerce, or business, etc., are undertaken in the course of actual carrying out of the advancement of the object of GPU, and (ii) the aggregate receipts from the aforesaid activities do not exceed 20 per cent of the total receipts of the charitable institution.
- If the consideration charged for such activities is on a cost-basis or nominally above the cost, then it indicates that the nature of activities are not in the nature of 'trade, commerce or business, etc.'. However, if the consideration charged is markedly or significantly above the cost incurred by the charitable institution, they would fall within the mischief of 'trade, commerce or business', and in that case, they will have to further comply with the quantitative restriction as prescribed in the second proviso to Section 2(15) (ie, 20% of total receipts).
- The Supreme Court distinguished its own decisions in the case of Surat Silk Mills<sup>4</sup> and Thanthi Trust<sup>5</sup>.

### **For statutory corporations /authorities discharging public functions<sup>6</sup>:**

Statutory corporations and authorities engaged in housing development, supply of water, etc. sectors are involved in the advancement of objects of GPU. Therefore, they are considered charities in the GPU categories. Further, the Supreme Court has laid down certain determinative tests for statutory bodies to qualify as GPU charities.

The amounts charged for achieving what is essentially 'public functions/services' (such as housing, supply of water, etc.) may resemble trade, commercial, or business activities, but they are essential for the advancement of public purposes, and such receipts are prima facie to be excluded from the mischief of 'business or commercial' receipts.

The tax authorities have been asked to examine whether the quantum of fees charged for such services are significantly higher than its cost, which would then attract the threshold limits prescribed under the Act sub-clause (ii) of the second proviso to section 2(15)<sup>7</sup>.

### **For statutory regulatory bodies/authorities like ICAI, etc<sup>8</sup>:**

The income and receipts of statutory regulatory bodies, which are responsible with exclusive duties of prescribing curriculum, disciplining professionals, and prescribing standards of professional conduct, are prima facie, not business or commercial receipts.

The tax authorities shall examine the fees charged by such regulatory bodies. If the level of such fees or collection are significantly higher than the cost, such income may constitute an activity of commercial nature, and then the threshold limits prescribed under the provisions of the Act have to be complied with. proviso to Section 2(15) and would have to be within the limits prescribed by sub-clause (ii) of the proviso to Section 2(15).

### **For trade promotion bodies:**

Bodies involved in trade promotion (such as AEPC) are set up with the objects of purely co-ordinating and assisting trading organisations, can be said to be involved in the advancement of objects of GPU and not carrying on 'trade, commerce or business'.

<sup>4</sup> ACIT v. Surat Art Silk Cloth Manufacturers Association [1978] 121 ITR 1 (SC)

<sup>5</sup> ACIT v. Thanthi Trust [2001] 247 ITR 785 (SC)

<sup>6</sup> Gujarat Industrial Development Corporation, Gujarat Housing Board, etc.

<sup>7</sup> The aggregate receipts from such activities do not exceed 20% of the total receipts of the trust

<sup>8</sup> Andhra Pradesh Seeds Certification Authority, Institute of Chartered Accountants of India, etc

However, if such organisations provide additional services such as courses meant to skill personnel, providing private rental space in fairs or trade shows, consulting services, etc., then income or receipts from such activities, would be business or commercial in nature. In that event, the claim for tax exemption would have to be again subjected to the threshold limits prescribed under the Act. of the proviso to Section 2(15) of the IT Act. In this category of institutions, the SC has not referred to the primary examination of the nature of charges for the 'additional services', i.e., whether it is at cost or at a nominal mark-up, for it to not qualify as 'trade, commerce or business, etc.' Hence, all activities seem to be subject to the threshold limit test straight away.

### **For non-statutory bodies:**

Normally, the functions performed by non-statutory bodies, like ERNET and NIXI, are driven by charitable purposes, but the claims of other such non-statutory organisations performing public functions need to be ascertained on an annual basis. The tax authorities may determine whether the fees and the mark up charged are nominally above the cost or at a much higher level.

It is held that though GS1 India is involved in the advancement of GPU, its services are for the benefit of trade and business, from which they receive significantly high receipts. In these circumstances, its claim for exemption cannot succeed. However, the Court does not rule out any future claim made if GS1 is able to satisfy that what it provides to its customers is charged on a cost-basis with, at the most, a nominal markup.

### **For sports associations:**

SC observed that the activities of the Cricket Associations are run on business lines as they own physical and other infrastructure, have arrangements for permanent manpower, and have well-organised supply chains to cater to the several matches they host.

On close scrutiny of the expenses borne, having regard to the nature of receipts, the expenditure incurred by Cricket Associations does not disclose that any significant proportion is expended towards sustained or organized coaching camps or academies.

In the background of the aforesaid observations, the SC held that the aspect of the corpus subsidies received by other cricket associations to BCCI (treated as tax-exempt by the recipient cricket associations) should be re-examined. The tax authorities have been directed to carefully examine the pattern of receipts and expenditure, the nature of media rights sold to successful bidders, and the arrangement between BCCI and other affiliated

cricket associations. The tax authorities have been directed to adjudicate the matter afresh and consider the facts and the relevant material to examine the nature of activities and pass an appropriate order.

### **For private trusts**

In the case of Tribune Trust, the Supreme Court observed that despite advancing GPU, the trust could not benefit from the exemption provided under Section 2(15) because the income received from advertisements, constituted business or commercial receipts, and the statutory monetary limit (20% of total receipts) had also been exceeded.

The activities to be included in 'trade, commerce or business' would have to be seen on a case-to-case basis.

### **Our comments**

The current decision has overruled the past principle of 'predominant object' laid down in its previous decision in the case of Surat Silk Mills in light of the amendments introduced to Section 2(15).

The Supreme Court has prima-facie held that if any fees or cess or any consideration is charged for undertaking any activity in the nature of trade, commerce, or business, then a two-pronged approach has to be adopted – (i) First, it needs to be tested if the consideration charged is on a cost basis or involves nominal/substantial mark-up. If so, then the nature of activities is not 'trade, commerce or business, etc.' (ii) Second, if the first test is not satisfied (i.e., the nature of activities is indeed 'trade, commerce or business, etc.', then the threshold limit (less than 20 per cent of overall receipts) has to be applied, to qualify for the tax exemption.

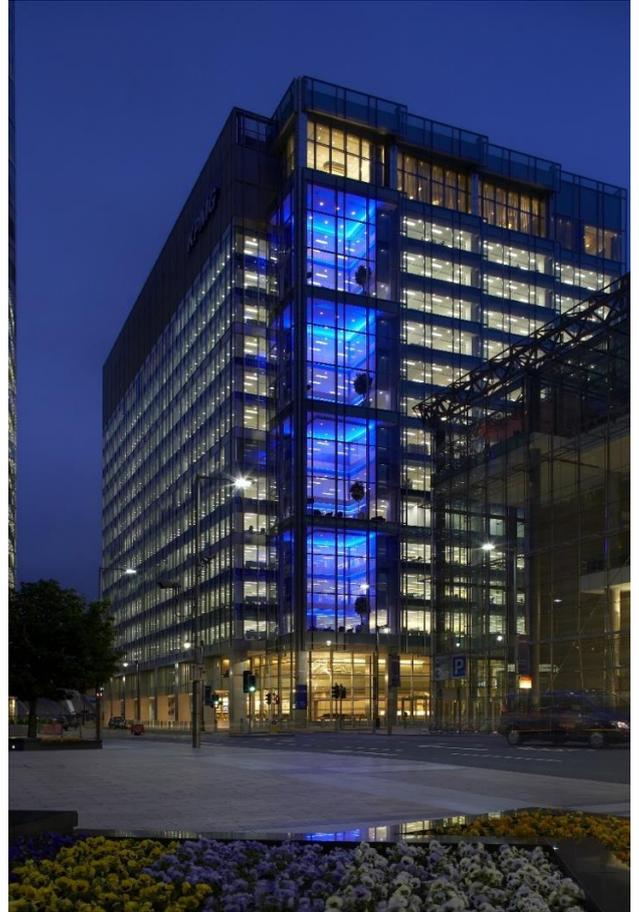
However, no guidance has been provided as to what shall constitute a high-mark up and how to determine the same. This can therefore become a very subjective test.

Also, the aforesaid activities in the nature of 'trade, commerce, business, etc.' should fulfill the requirement of being "incidental activities". Activities can be said to be "incidental" only if the activities are actually conducted in the course of achieving the object of GPU. The SC has observed that there is a difference between the phrase '*activities actually conducted in the course of achieving the GPU objects*' vis-à-vis '*income from incidental activities*'. As per the SC, the latter category is not 'incidental' but only the former.

The tax department has been empowered to scrutinise the records on a yearly basis to discern whether the nature of the taxpayer's activities amount to 'trade, commerce or business' based on its receipts and income (i.e., whether the amounts charged are on a cost-basis, or significantly higher) and whether it is qualified for the exemption

Further, dealings between the trade promotion bodies with their members need to be analyzed carefully to evaluate if it qualifies for Section 2(15) in light of the above decision.

This decision will incentivise the tax department to undertake detailed and regular scrutiny of the activities of any charitable organisation and may lead to the initiation of re-assessment proceedings for entities registered under the residuary category of GPU.



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