

TAX FLASH NEWS

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The taxpayer is not eligible for charitable institution related approval since it is involved in commercial activities

Recently, the Hyderabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Fernandez Foundation¹ (the taxpayer) dealt with granting of charitable institution related approval for exemption after the conversion of a private limited company into a charitable company. The Tribunal held that the taxpayer was running the activities on a commercial basis and at a market rate even after conversion and such activities were not of charitable nature. The Tribunal observed that the taxpayer, after conversion, could have done charity by either bringing down its profit by providing services at a reasonable rate or by utilising the surplus for helping medical aid/facilities to the poor and needy persons free of cost. However, the taxpayer had not done anything of this nature. Therefore, the taxpayer was not entitled for registration or approval as a charitable institution².

Facts of the case

- The taxpayer was a private limited company. It was converted into a Charitable Company under Section 8 of the Companies Act, 2013. The taxpayer changed its name to 'Fernandez Hospital'. However, while filing an application for registration as a charitable institution under the Income-tax Act, 1961 (the Act), the taxpayer had given its name as 'Fernandez Hospital Foundation'.
- The application of the taxpayer was rejected by the Commissioner of Income-tax (Exemption) [CIT(E)] due to ambiguity with regard to the name of the taxpayer and also a list of directors. Further, the taxpayer was involved in activities which are in the nature of trade and providing

services at market rates. The taxpayer had also violated the provision of Section 13, as huge amounts were paid to the directors/ interested persons.

- The taxpayer contended that the activities conducted by it were charitable in nature and CIT(E) had wrongly rejected the taxpayer's application for a grant of registration as a charitable institution.

Tribunal's decision

- The taxpayer was running the activities on a commercial basis and such activities were not of charitable nature. The taxpayer had failed to bring on record any comparative chart of diagnostic charges, procedure charges, test charges, etc., to show a significant reduction in fee/charges after conversion.
- If the taxpayer's arguments were accepted that only the subsequent period's documents should be taken into consideration, even though the taxpayer was a profit-earning private company prior thereto, then it would be a handy tool for an otherwise profit-making company to conveniently convert into a charitable company and avoid payment of due taxes.
- In the present case, the taxpayer's activities, management, place of services or the charges for treatment had not been changed in any manner by conversion and only the taxpayer's name had changed.
- The Tribunal observed that the taxpayer could have done charity by either bringing down its profit by providing services at a reasonable rate or by utilising the surplus for helping medical aid/facilities to the poor and needy persons free of cost. However, the taxpayer had not done anything of this nature.

¹ Fernandez Foundation v. CIT (ITA No.1884 & 1885/Hyd/2019) – Taxsutra.com

² Under Section 12AA, 80G and 10(23C)

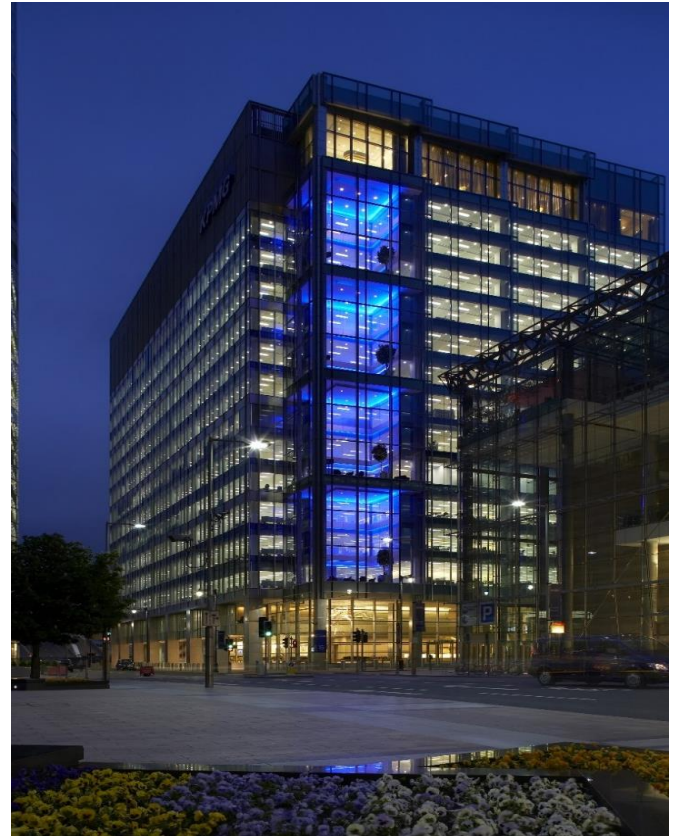
- In the instant case, the free treatment / concessional rate was less than 1 per cent of the taxpayer's revenue³.
- The Tribunal relied on the decision of the Supreme Court in the case of New Noble Educational Society⁴ and observed that the CIT(E) was well within his right to examine the audited records /other financial statements with a view to deciphering the nature of the activities.
- Accordingly, the taxpayer was not entitled for registration or approval as a charitable institution.

Our comments

The Tribunal in this decision has observed as follows while reiterating the principles laid down by the recent Supreme Court decisions in the case of New Noble Educational Society and Ahmedabad Urban Development Authority:

- At the time of granting approval, the CIT(E) is well within its powers to look into the financials and the manner in which activities have been conducted. There is no need to merely rely on the stated intent as per the objects clause
- The charitable intent has to be substantiated through the quantum of mark-up charged over the cost. The mark-up cannot be significant. Merely providing some free / concessional treatment (in the present case merely 1 per cent of the revenue) was not sufficient to prove the charitable intent of the taxpayer.

It is important for organisations to benchmark / compare their activities and charges with other charitable and commercial organisations to substantiate its charitable intent.



³ ACIT(E) v. Ahmedabad Urban Development Authority [2022] 143 taxmann.com 278 (SC) referred

⁴ New Noble Educational Society v. [2022] 143 taxmann.com 276 (SC)

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