

TAX FLASH NEWS

14 November 2022

Capitation fees received by an educational institution are not eligible for exemption available to a charitable trust

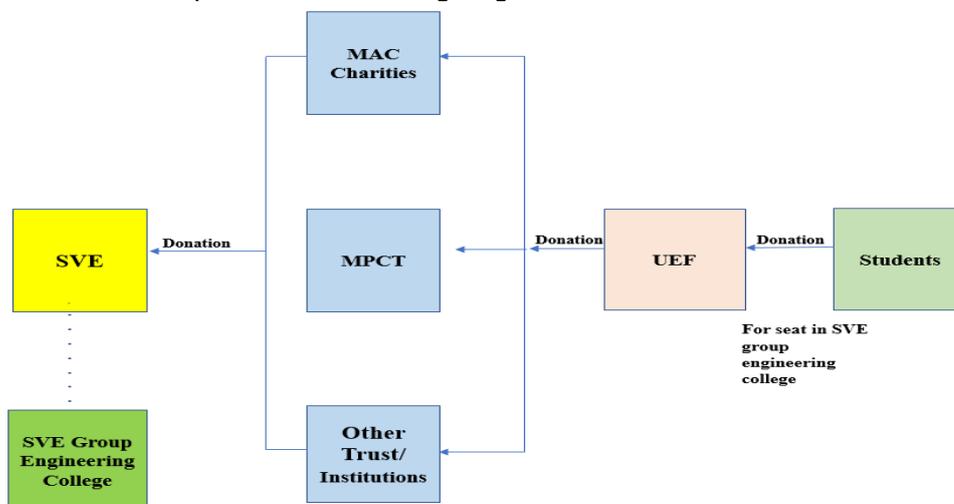
Executive Summary

Educational institutions and trusts accept donations from students and other parties in the course of providing education. Whether acceptance of such donations is a voluntary contribution and thus liable for exemption under Section 11 of the Income-tax Act, 1961 (the Act)¹. This issue has been a matter of debate before the courts. Institutions have been arguing that such donations are voluntary in nature, the application of the donated money is towards the object of the institution and the institutions are free to donate or take donations from any parties. However, the tax department has been denying the claim observing that such donations are in the nature of capitation fees, the same are not voluntary in nature and they are against the relevant state laws as well as under the relevant provisions of the Act.

Recently, the Madras High Court in the case of MAC Public Charitable Trust² (MPCT) dealt with this issue and held that the amounts collected as donations were in the nature of capitation fees and they were directly connected with the allotment of seats in the related entity's engineering college. The same were not voluntary contributions and not applied for charitable purposes. The High Court lifted the veil and observed that the modus operandi adopted by the trusts and institutions in the instant case was for circumventing the provisions of the relevant state law³. Further, it was for evading tax through distinct entities receiving funds from each other for charitable purposes. Therefore, such capitation fees were not eligible for exemption under Section 11.

Facts of the case

- Sri Venkateswara Educational and Health Trust (SVE) received corpus donations from MAC Charities, MPCT, etc. The transaction is depicted in the following diagram:



Note - Fees were indirectly paid through relatives and friends of the parents of the students

¹ Exemption for income from property held for charitable or religious purposes

² MAC Public Charitable Trust v. CIT (TCA No. 303/2021) – Taxsutra.com

³ Tamil Nadu Educational Institutions (Prohibition of Collection of Capitation Fee) Act, 1992

- The Assessing Officer (AO) noticed that the said amount was originally paid to United Educational Foundation (UEF) in lieu of procuring seats in Sri Venkateswara College of Engineering, a unit of the SVE. UEF transferred such amount through MAC Charities, MPCT and other organisations to SVE.
 - The AO observed that SVE utilised UEF, MAC Charities, MPCT as a tool for the transfer of capitation fees received from the students. Such practice of receiving a capitation fee as a condition precedent for admitting a student is a violation under the provisions of the Tamil Nadu Educational Institutions (Prohibition of Collection of Capitation Fee) Act, 1992 [TNEI Act].
 - Therefore, the AO held that the receipt of capitation fees a non-voluntary contribution is not eligible for exemption under Section 11 which is available to a charitable trust. Therefore, the AO denied the exemption claimed by above charitable trusts/institutions.
- The Tribunal held that the statements recorded from the donors revealed that they made the donations voluntarily to the charitable institutions. There is no bar for the trusts to receive and/or accept voluntary donations from the donors or from the relatives and parents of the students studying in the educational institutions connected with the charitable trusts. The AO had not brought out credible materials to show that the trusts had received donations as a condition precedent for allotment of seats to the student. Accordingly, the Tribunal allowed the exemption under Section 11.

High Court's decision

The High Court held that the amounts collected as capitation fees were for the allotment of seats in the college and they were in violation of the TNEI Act. They were neither voluntary contributions nor applied for charitable purposes. Therefore, such capitation fees were not eligible for exemption under Section 11. The High Court observed as follows:

Income-tax Act and TNEI Act

- As per the TNEI Act, any amount collected in excess of the prescribed fee, either directly or indirectly is to be treated as a capitation fee, irrespective of whether it is a voluntary contribution or donation. There is a prohibition for the educational institution or the person in-charge to collect any amount in the nature of the capitation fee. Further, prohibition is also against a collection of any amount by any other person either for himself or on behalf of an educational institution or management of such educational institution.
- As per Act as well as the TNEI Act, collection of any amount in excess of what has been prescribed as a fee either directly or indirectly or through some other person or institution or trust, for the seat in any educational institution would render the activity of both the entities pretentious. Such actions would render the object of 'charity' a farce and the transaction would have to be treated as a commercial activity, denying the benefits of Sections 11 and 12.

Lifting the veil

- There is no bar to apply the doctrine of 'lifting the corporate veil' in case of trusts. In the instant case, trusts were controlled by common trustees and were sister trusts. Thus, the High Court was forced to lift the veil to see the real beneficiaries and the object of the donations.
- On lifting the veil, it was clear that the modus operandi adopted by the trusts and institutions was with the objective of circumventing/violating the provisions of the TNEI Act. Further, it was for evading tax while seeking tax exemption under the veil of being different and distinct entities receiving funds from each other for charitable purposes.

Voluntary contribution

- Unless a contribution is made gratuitously and without consideration, it cannot be treated as a 'voluntary contribution' for the purpose of availing exemption under Sections 11 and 12. The Supreme Court in *Safdarjung Enclave Educational Society*⁴ held that any donation made in order to gain an advantage or benefit cannot be called as a voluntary contribution.
- There was multiple evidence that the contributions were non-voluntary, such as, the detailed sworn statements of the persons who had made the contributions, the nexus between the other SVE institutions which collected and passed on the contribution, common trustees, etc.

⁴ *Safdarjung Enclave Educational Society v. MCD* [AIR 1992 SC 1456]

- When the contributions cannot be treated as voluntary, there was no further question of their application to charitable purposes or otherwise. Therefore, such trusts and institutions were not entitled to the benefit of Sections 11 and 12 and the AO was directed to cancel the 12A registration and not treat the respondents as charitable institutions any longer.
- The High Court did not agree with the CIT(A) and the Tribunal's observations that the collection of donations was in line with the objects.

Our Comments

The court has reiterated that it is beyond doubt that **education can never be a commercial activity or a trade or business** and those in the field of education will have to constantly and consistently abide by this guiding principle.

It has been clearly held that the long-winding and indirect route adopted for capitation fees to reach the institution cannot change the basic character of the payment from an illegal capitation fee to a voluntary contribution/donation.

The modus deployed by the assessee of using related trusts and inter charity transactions is an area that the tax department scrutinizes carefully. It will be important to ensure compliance with any related party requirements to ensure maintenance of tax exemption.

The observation on what may be construed as genuine is relevant. The word "genuine" in the context of exemption provisions must be read in compliance with all laws of the land. If the institution or trust is used as a cloak to violate the law, irrespective of whether any benefit is achieved or not the benefit of registration cannot be permitted. It will be important for all charities to ensure compliance with all material laws.

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