



BUSINESS ACTIVITY AND TAX EXEMPTION ON CHARITABLE TRUSTS IN INCOME TAX LAW

K.N. Chaturvedi

I

RELIGIOUS AND charitable trusts exist in one form or the other in almost all the civilized societies. Their origin can be traced primarily to the instinct of piety and benevolence which are implanted in human nature. In India, by tradition, philanthropy has been playing a significant role in enriching our cultural heritage and in catering to the educational, medical, socio-economic and religious needs of the people. In so doing it has supplemented the work of a welfare state and the state in turn has recognised its contribution by giving generous tax-treatment.¹

Under the Indian income-tax laws, a charitable trust has received a favoured and preferential treatment since 1886. This is evident from the various provisions of the Income-tax Acts of 1918, 1922 and 1961. The current legislation pertaining to our study is the Income-tax Act, 1961. This Act while granting exemption on income from religious and charitable trusts has taken effective measures to minimise misuse of trust funds.² Thus, a charitable trust loses exemption if certain provisions are not complied with provided the claim do not fall under section 10 of the Act. These provisions lay down that an irrevocable trust is to apply its income to the charitable objects within a specified period, maintain proper accounts and get them audited and invest or utilise funds in such a manner that no benefit is derived by the settlor, trustees, their relatives and other persons.³

The scope of definition "charitable purpose" in the Act of 1961 has been subject to judicial controversy particularly the words "not involving the carrying on an activity for profit" in the last limb of the definition.⁴

*LL.M. (Allahabad), Lecturer in law, Kurukshetra University.

1. See s. 5 of the Income-tax Act of 1886 which ran:

S. 5(i) Nothing in Section 4 shall render liable to tax... (e) any income derived from property solely employed for religious or public charitable purposes.

See also s. 3 of the Income-tax Act of 1918 which ran thus :

S. 3(2) Act would not apply to the following classes of income—

(i) any income derived from property held under trust or other legal obligation wholly for religious or charitable purposes and in case of property so held in part only for such purposes, the income applied or finally set apart for application, thereto.

2. See ss. 11, 12 and 13 of the Income-tax Act, 1961.

3. See ss. 11, 12, 12-A and 13 of the Income-tax Act, 1961.

4. *Id.* s. 2(15).



This paper seeks to examine the implications of the words "not involving the carrying on an activity for profit" in view of varying judicial interpretations. Further, the paper, examines the legislative attempts of a similar nature in the Income-tax Act, 1922.

II

Tax exemption regarding religious and charitable trusts was a *sine qua non* of statutory enactments. The provisions of the Act of 1922 entitled a trust to claim tax exemption on its income from business activity provided a trust was created thereon. The word "property" occurring under section 4(3)(i) of that Act was held to include a business also.⁵ The Privy Council in *In re The Trustee of the 'Tribune'*⁶ held that the income of the Tribune Press fell within section 4(3)(i) and implied in it the finding that income from the press was derived from property held under trust to maintain a newspaper, to keep up its liberal policy and to devote surplus funds to improve the newspaper.

To eliminate business activity of trust which were otherwise entitled for tax exemption under the 1922 Act, the Act was amended twice. First major amendment of 1939⁷ inserted a new clause (ia) in the then existing provisions. This amendment provided that income derived from business carried on by or on behalf of a charitable trust or religious institution should be limited to only such business income as was derived by the trust or institution from business carried on either in the course of the carrying on of a primary purpose of the trust or the institution or carried on mainly by the beneficiaries of the trust or institution. This amendment did not receive the approval of the court. In the Lahore High Court's case of *Charitable Gadodia Swadeshi Stores v. C.I.T.*,⁸ Din Mohomad, J., observed :

Viewed in its proper perspective, therefore, clause (ia) can be taken to apply only such business as is carried on on behalf of religious

5. *C.I.T. v. Cotton Textile Export Promotion Council*, 67 I.T.R. 539 (1968). See also *C.I.T. v. Krishna Warriar*, 53 I.T.R. 176 (1964); *Thiagesar Dharma Vanikam v. C.I.T.*, 50 I.T.R. 798 (1963).

6. 7 I.T.R. 415 (1939).

7. See s. 4 of the Indian Income-tax (Amendment) Act, 1939, which ran as follows :

(ia) Any income derived from business carried on on behalf of a religious or charitable institution when the income is applied solely for the purposes of institution and—

(a) business is carried on in the course of carrying out of a primary purpose of the institution ; or

(b) the work in connection with the business is mainly carried on by beneficiaries of the institution.

8. 12 I.T.R. 385 (1944). See also *C.I.T. v. Radhaswami Satsang Sabha*, 25 I.T.R. 472 (1954); *J.K. Trust v. C.I.T.*, 32 I.T.R. 535 (1957).



or charitable institutions which were not held under trust and not to such business as was itself held under trust or was conducted by or on behalf of such charitable or religious institutions as were held under trust. If it was intended to narrow down the scope of clause (1) so as to withdraw the exemption enjoyed by a business held under trust or conducted by or on behalf of a religious or charitable trust, the new clause should have been added as proviso to the old clause.^{8a}

To meet this unhappy situation the Act was again amended in 1953.⁹ Under the Finance Act of 1953, clause (ia) was deleted from section 4(3)(i) of the Act of 1922 and was transferred to clause (i) of section 4(3) as its proviso.¹⁰ The intention of the legislature in transferring the old clause (ia) into a proviso to clause (i) was that in case of business carried on on behalf of a religious or charitable institution, the conditions prescribed in para (b) of the proviso to clause (i) should be satisfied in addition to the general condition of exemption set out in the substantive part of clause (i). The attempt of the legislature to exempt income from business activity on complying other conditions apart from those laid down in clause (i) was again judicially disapproved. The Supreme Court observed :

The legal position may briefly be stated thus : Clause (i) of section 4(3) of the Act takes in every property or a fractional part of it held in trust wholly for religious or charitable purposes. It also takes in such property held only in part for such purposes. Business is also property within the meaning of said clause. Clause (b) of the proviso to section 4(3)(i) applies only to business not held in trust but carried on on behalf of religious or charitable institutions.^{10a}

The judicial disapproval of the above stated amendments helped the assesseees to use public trust as a media for concentration of economic power. It helped them to create monopoly in business and industry by investing public trust money in their own organisations.¹¹

8a. *Id.* at 390-91.

9. See s. 4 of the Finance Act, 1953 adding proviso to s. 4(3)(1) :

- (b) in the case of income derived from business carried on on behalf of religious or charitable institution, unless the income is applied wholly for the purposes of institution and either—
- (i) the business is carried on in the course of the actual carrying out of a primary purpose of institution ; or
 - (ii) the work in connection with the business is mainly carried on by beneficiaries of the institution.

10. *C.I.T. v. Krishna Warriar*, *supra* note 5.

10a. *Id.* at 186.

11. See the *Tyagi Committee Report 1958-59*.



III

The Income-tax Act, 1961 amended the definition of the charitable purpose so as to deny tax exemption on such activity for profit which were carried on by a trust for the advancement of an object of general public utility.¹²

The reason given for the same was that the advantage by way of tax exemption should not be given to such charitable trust under section 11 of the Act which include a commercial concern, which while ostensibly serving a public purpose get fully paid for the benefits provided by them.¹³

Not involving the carrying on an activity for profit

The aforesaid expression was intended to curb on the materialistic activities of individuals and institutions carrying on under the deceptive veneer of charitable purpose.¹⁴ The controversy centered round the question whether these words envisage a total exclusion of an activity for profit or permitting the carrying on of such activity within certain limits.¹⁴ It has now been settled that where the object of the trust is the relief to the poor, advancement of education or medical relief and the trust is permitted by its rules to carry on any activity for profit, even then exemption shall be available under section 11.¹⁵ Thus, these words qualify the fourth object mentioned in the definition of "charitable purpose" viz, the advancement of an object of general public utility.

We shall now discuss what are the objects of general public utility and how the restriction of carrying on an activity for profit apply thereon.

12. The Act of 1961, s. 2(15) reads :

"Charitable purpose" includes relief to the poor, education, medical relief and the advancement of any other object of general public utility not involving the carrying on of any activity for profit.

13. The then Finance Minister Morarji Desai stated in the *Lok Sabha* :

The definition of 'charitable purpose' in that clause is at present so widely worded that it can be taken advantage of even by commercial concerns which, while ostensibly serving a public purpose, get fully paid for the benefits provided by them, namely, the newspaper industry which while running its concern on commercial line can claim that by circulating newspapers it was improving the general knowledge of the public. In order to prevent the misuse of this definition in such cases, the Select Committee felt that the words 'not involving the carrying on of any activity for profit' should be added to the definition.

LVI *L.S.D.*, 32nd ses., p. 3073 (Aug. 18, 1961).

14. See *C.I.T. v. Indian Chamber of Commerce*, 80 I.T.R. 645 (1971) (Kerala); *C.I.T. v. Indian Chamber of Commerce* 81 I.T.R. 147 (1971) (Calcutta); *C.I.T. v. Sole Trustee, Loka Shikshana Trust*, 77 I.T.R. 61 (1970) (Mysore).

15. See *Adll. C.I.T. v. A.L.N. Rao Charitable Trust*, 102 I.T.R. 474 (1975) (S.C.). The Taxation Laws (Amendment) Act, 1975 has inserted a new clause in s. 13(1) (bb) which has restricted the exemption.



Object of general public utility

The words "any other object of general public utility" were inserted as an explanation to section 3(2) of the Income-tax Act, 1918, to clear of the doubts of the English courts regarding the concept of charitable purpose.¹⁶

The term "object of general public utility" was contained in the 1922 Act.¹⁷ It included the advancement of any object of benefit to the public or a section of public as distinguished from an individual or a group of individuals.¹⁸ Thus, the requirement of public welfare in such activity becomes essential. On the basis of this test an association for promotion of unity and brotherhood in a community or for the protection of trade, commerce and industry or arranging transport facilities or running the business of newspaper were held to be an object of general public utility.¹⁹

Conversely no public welfare is achieved if the object of trust is limited to the welfare of the employees of the trust or is limited to protect and promote the personal interest of those members of the trust who control a particular trade or is confined to the terms and conditions of employment in mills of the assessee's association.²⁰ The court held that in above cases the trust was held by the assessee not for an object of general public utility. On similar grounds a trust for promotion and encouragement of entertainment was held not for charitable purposes as it lacked the condition of public benefit.²¹

After satisfying the requirement that the trust is held for an object which is advancement of an object of general public utility it is to be proved that it did not involve the carrying on an activity for profit. The words not involving the carrying on an activity for profit were interpreted

16. In England charitable purpose was defined in *Commissioners for Special Purposes v. Pense*, [1891] A.C. 531 thus:

"Charity" in its legal sense comprises four principal divisions : trust for the relief of poverty, trust for the advancement of education, trust for the advancement of religion ; and trust for other purposes beneficial to community . . . (at 583, per Lord Macnaghten)

17. See s. 4(3)(i) of the Act of 1922 See also s. 2(15) of the Act of 1961.

18. *C.I.T. v. Ahmedabad Rana Caste Association*, 88 I.T.R. 354 (1973) (Gujarat).

19. *Ahmedabad Rana Caste Association v. C.I.T.*, 82 I.T.R. 704 (1972) (S.C.); *Indian Chambers of Commerce v. C.I.T.*, 101 I.T.R. 796 (1975) (S.C.); *Andhra Pradesh State Road Transport Corporation v. C.I.T.*, 100 I.T.R. 392 (1975); *Sole Trustee, Lok Skishana Trust v. C.I.T.*, 101 I.T.R. 234 (1975) (S.C.).

20. *Zenith Tin Works Charitable Trust v. C.I.T.*, 102 I.T.R. 119 (1976); *Additional Commissioner of Income Tax v. Ahmedabad Millowners' Association*, 106 I.T.R. 726 (1977); *C.I.T. v. Indian Sugar Mills' Association*, 97 I.T.R. 486(1974) (S.C.).

21. *South India Athletic Association v. C.I.T., Madras*, 107 I.T.R. 108 (1977).



differently by the revenue department and the assessee (the charitable trusts seeking tax exemptions under section 11 of the Act.) The contention of the revenue in cases before the court was that the words would mean that a charitable trust would forfeit exemption on its income if it involved in any activity for profit. Whereas, the contention of the charitable trust seeking tax exemption under section 11 was that the words not involving the carrying on any activity for profit could never take place where the dominant object of the trust was advancement of an object of general public utility and any profit resulting to the trust from its business activities was a bye-product. Unfortunately the views of the different High courts were not uniform in this regard.

The Kerala High Court held²² that where the object of the trust was to provide service to its members and not to carry on business for profit, the trust could not be said to have been hit by the words, not involving the carrying on any activity for profit, in the definition of the charitable purpose. The same court observed similarly in another case.²³

The view of the Kerala High Court was followed by the Andhra Pradesh High Court in *Andhra Pradesh Road Transport Corporation v. C.I.T.*²⁴ The court observed that the statute under which the Andhra Pradesh Road Transport Corporation was created did not bar business activity from any public utility concerned but restricted the benefit to those concerned only whose object was not to make profits but to be of utility to the public. Exemption under section 11 of the Act was granted in this case to the assessee on its income from transport business.

On the other hand was the view of the Calcutta and Mysore High Courts. The Calcutta High Court held that a trust cease to be charitable if its object, the advancement of an object of general public utility, is intertwined with an activity for profit.²⁵

The Supreme Court settled the controversy by observing that the words "not involving" an activity for profit under section 2 (15) of the Act of 1961 mean an activity carried on by a trust on no profit basis.²⁶ In *Sole Trustees*' case the Supreme Court held that the exemption under section 11 of the Act was not granted to the trust as the trust was con-

22. *C.I.T. v. Indian Chamber of Commerce*, 80 I.T.R. 645, *supra* note 14.

23. *C.I.T. v. Dharmodayam Co.*, 94 I.T.R. 113 (1974) (Kerala). In this case the court held that where the assessee company was conducting a profitable business of running a chit fund and its memorandum of association stated as one of its objects "to do the needful for the promotion of charity, education and industry", the assessee was held to be entitled for exemption under section 11 of the Act.

24. *Supra* note 19. In this case the corporation was to utilize the surplus income from its transport business for the construction and repairs of the roads and on other objects of similar nature.

25. *C.I.T. v. Indian Chambers of Commerce*, 81 I.T.R. 147, *supra* note 14; *C.I.T. v. Sole Trustee, Lok Shikshana Trust*, *supra* note 14.

26. *Sole Trustee, Lok Shikshana Trust v. C.I.T.*, *supra* note 19.



ducting business of printing and publishing apparently on commercial lines. The loosely stated objects of the trust, wide powers of the sole trustee and the statement of total expenditure disclosed that the trust was involved in carrying on an activity for profit. In the *Indian Chamber of Commerce*,^{26a} the Supreme Court held that the exemption under section 11 of the Act was not available as the assessee derived profit from its activities in course of fulfilling its object of promotion and advancement of trade and commerce. The court held the income of chamber through (a) arbitration fee (b) fee for certificate of origin and (c) fee charged for weighment and measurement, as arising from profit making activities.

Two years later in *C.I.T. v. Dharmodayam Co.*²⁷ the Supreme Court again considered the question relating to the interpretation of section 2(15) of the Act in general and exemption from tax under section 11 on income derived from conducting the business of *kuries* by the trust in particular.

The Supreme Court refused to accept the contention that by reason of the change introduced by the 1961 Act in the definition of 'charitable purpose' under section 2(15) of the Act did not effect the decision of Kerala High Court in *Dharmodayam Co's case*²⁸ in deciding the question relating to tax exemption by the assessee on income derived from the business of *kuries*.

It is submitted that the Supreme Court's decision in the *Dharmodayam Co. case* has again reopened the fear expressed by it in its earlier decision of *Indian Chamber of Commerce v. C.I.T.*²⁹ regarding the dangerous consequences arising out of misconstruction of the provision of section 2(15) of the 1961 Act.

In the *Indian Chamber of Commerce case*, the Supreme Court highlighted that if the *ratio* in the *Dharmodayam Co. case* as decided by the Kerala High Court "were to hold good, businessmen have a highroad to tax avoidance".^{29a}

In an earlier case the Madras High Court³⁰ held that the words "not involving the carrying on an activity for profit" were not applicable where the income derived from the trust was not planned or it was a result

26a. *Supra* note 19.

27. *C.I.T. v. Dharmodayam Co.*, 109 I.T.R. 527 (1977).

28. *Supra* note 23.

29. *Indian Chamber of Commerce v. C.I.T.*, *supra* note 19.

29a. *Id.* at 808.

30. *C.I.T. v. Madras Stock Exchange and Others*, 106 I.T.R. 546 (1976). In this case the court held the rental income of the Andhra Chamber of Commerce, income received by the Southern Indian Film Chamber of Commerce acting as an instrument of certain standard, income derived by the Southern Indian Chamber of Commerce by holding exhibition on golden jubilee festival of the association *viz.*, the Southern Indian Chamber of Commerce and income received by the Madras Stock Exchange Limited from preparation and sale of year book, market reports, listing fee, as not arising out of carrying on any activity for profit.



of complying certain administrative standards.

IV

A perusal of the cases discussed above shows that it is difficult to reconcile them where an activity is carried on for profit by a charitable trust and where it is not so provided, the trust is held for an object of general public utility. It is urged that the recent decision of the Supreme Court in *Dharmodayam Co's case*³¹ needs careful consideration in view of the observation made earlier in the *Indian Chamber of Commerce* case where the court held that if the *ratio* in *Dharmodayam Co.'s case* "were to hold good, businessmen have a highroad to tax avoidance."

In the *Indian Chamber of Commerce*,^{31a} the Supreme Court observed that a charitable trust does not involve in carrying on an activity for profit if it has done so on no profit basis. Further, the court admitted the impracticability of drawing a precise mathematical line to conclude that no profit should not mean no surplus provided the byelaws of a charitable trust or surrounding circumstances negative profit motive either expressly or impliedly. It is submitted that a genuine trust having surplus income, claiming an exemption under section 11 of the Act will have to pass through an ordeal of judicial interpretation of its byelaws.

The Madras High Court's decision³² discussed above has created some difficulties to the revenue authorities. The court held that where a building was found to be too spacious by the assessee *i.e.* Andhra Chamber of Commerce, a charitable trust, and the surplus part of the building is let out on rent, the rental income shall not be deemed to have arisen from an activity carried on for profit. How it can be determined that the surplus part of the building let out by the assessee was because of chance or by a predetermined action of the assessee. Facts adduced by the assessee in similar cases may not prove convincing in all cases. The same court held for assessee *i.e.* the Southern India Chamber of Commerce that the income of the assessee from holding exhibition on golden jubilee festival of the chamber was out of a chance event and hence the income was granted exemption under section 11 of the Act. The reason given by the court that if the assessee carried on an activity for profit only once as in the above case the assessee is not said to have carried on an activity for profit so as to hit by section 2 (15) of the Act. The above decision of the court granting exemption under section 11 of the Act to a charitable trust on its chance income or fortuitous gains requires a careful consideration.

The same court held for the assessee Southern India Film Chamber of Commerce that income derived by the assessee from distribution of raw

31. *Supra* note 27.

31a. *Supra* note 19.

32. *Supra* note 30.



film or cinematograph films was exempt under section 11 of the Act. The reason for exemption was that the assessee undertook the obligation of storing film in their vaults at the instance of the Chief Inspector of Explosives and of distributing raw films at the instance of the Controller of Import and Export. The reason that the assessee was acting as an instrument of the government for the purposes of ensuring certain standards for storing films or their distribution thereof will discriminate an assessee acting for the government with another assessee who fails to be an agent of the government. The governmental interference in granting exemption to the income of charitable trust was increased further by inserting a new clause that is section 10(23C)³³ by the Taxation Laws (Amendment) Act, 1975.

Under section 10(23C) (iv) the central government is empowered to grant exemption by an official notification to the income of any charitable trust. It is apprehended that wide discretionary powers of the central government in this regard may lead to corruption both official as well as political. In this regard it is submitted that section 10(23C) (iv) requires an addition before the words "importance throughout India or throughout States or State." The word public should be added before the word importance so as to limit the discretionary power of the central government. Further the Taxation Laws (Amendment) Act, 1975 curtailed the scope of business activity of a charitable trust established for relief to poor, education or medical relief. A charitable trust may lose exemption under section 11 of the Act, if a business activity is carried on otherwise than for fulfilling primary purpose of the trust.³⁴ At the end, it is submitted that the government interference to exempt income of a charitable trust under section 10(23C) (iv) should be limited by making conditions for tax exemption more elaborate. A charitable trust having meagre assets should be treated favourably. Secondly, the judicial clarification of section 2(15) of the Act is to be taken up speedily in view of the Supreme Court's judgment in *Dharmodayam Co.'s* case.

33. S. 10(23-C) runs :

Any income received by any person on behalf of . . . (iv) any other fund or institution established for charitable purposes which may be notified by the Central Government in the Official Gazette, having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States . . .

34 S. 13(1) (bb) runs :

In the case of a charitable trust institution for the relief of the poor, education or medical relief, which carries on any business, any income derived from such business, unless the business is carried on in course of actual carrying out of a primary purpose of the trust or institution . . .