

Educational and Medical Institutions - Beware !

[Effect of omission of Ss.10(22) and 10(22A) from and amendment of S.10(23C) of, the Income-Tax Act 1961]

By : S. K. Tyagi

[Published in CTR Vol.153 (Art.) p.72 Part-II]

The Finance (No.2) Act 1998 has made far-reaching changes in the provisions of Income-Tax Act 1961 relating to the taxation of educational and medical institutions. The reasons for the same, as stated in the Finance (No.2) Bill 1998, are as follows :

“Under the existing provisions of clauses(22) and (22A) of section 10 of the Income-Tax Act, educational and medical institutions enjoy exemption from income-tax if they do not exist for purposes of profit. However, in the absence of any monitoring mechanism for checking the genuineness of their activities, these provisions are reported to be widely misused.

The Bill, therefore, seeks to omit the aforesaid clauses (22) and (22A) from the statute. The educational and medical institutions which are of charitable nature will henceforth have to claim income-tax exemption U/s. 11 and 12 of the Income-Tax Act subject to fulfilment of necessary conditions. In appropriate cases, the Central Government may also grant exemption by issue of a notification under sub-clause (iv) of clause (23C) of S. 10.”

Ss. 10(22) and 10(22A), before their omission, provided exemption to educational and medical institutions if they did not exist for the purposes of profit. To check the genuineness of the activities of such institutions the following monitoring mechanism has been incorporated.

- (i) Ss.10(22) and 10(22A) have been omitted with effect from the Assessment Year (A.Y.) 1999-2000.
- (ii) S.10(23C) has been amended to provide exemption to any income of such university or other educational institution or hospital or medical institution which is not established for the purposes of profit and -
 - (a) Which is wholly and substantially financed by the Government ; or
 - (b) Whose aggregate annual receipts do not exceed a prescribed amount (Annual receipts have been fixed at Rs one crore, vide newly inserted Rule 2-BC) or
 - (c) Which may be approved by the prescribed authority.
- (iii) Other educational and medical institutions which are of charitable nature will, henceforth, have to claim income-tax exemption U/s.11 and 12 of the Act, subject to fulfilment of necessary conditions.

2. Amendments made in S.10(23C), vide Finance (No.2) Act 1998.

S.10(23C) has been substantially amended / enlarged vide Finance (No.2) Act 1998 in order to provide exemption to any income of such university or other educational institution or hospital or medical institution which is wholly or substantially financed by the Government, or the income of which does not exceed a prescribed limit or which may be approved by the prescribed authority. The salient changes brought about in S.10(23C) are as follows :

- I. **S.10(23C) (iiiab) and (iiiac)** provide for exemption for the income of educational and medical institutions which are wholly or substantially financed by the Government.

II. **S.10(23C) (iiiad) and (iiiiae)** provide for exemption for the income of educational and medical institutions, the annual receipts of which do not exceed the prescribed amount (Annual receipts have been fixed at Rs one crore, vide newly inserted Rule 2-BC)

III. **S.10(23C) (vi) and (via)** provide for exemption for the income of educational and medical institutions other than those covered under S.10(23C)(iiiab) and (iiiac), (iiiad) and (iiiiae), which may be approved by the prescribed authority.

In the aforesaid provisions the expression “**Educational Institution**” stands for any university or other educational institution existing solely for educational purposes and not for purposes of profit ; whereas the expression “**Medical Institution**” stands for any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit.

1st proviso to S. 10(23C) lays down a condition that any educational or medical institution referred to in S.10 (23C) (vi) and (via) shall make an application in the prescribed form and manner to the prescribed authority for the purpose of grant of exemption or continuance thereof. Guidelines for approval U/s 10 (23 C) (vi) & (vi a) have been prescribed vide newly inserted Rule2CA. Such institutions may make an application in Form No. 56 D, to the Central Board of Direct Taxes, through Commissioner of Income-tax.

2nd proviso, further lays down that the Central Government may, before notifying the educational or medical institution, call for such documents or information as it thinks necessary, in order to satisfy itself about the genuineness of the activities of such institution and that Government may also make such enquiries as it may deem necessary in this behalf.

3rd proviso lays down that such educational or medical institution covered U/s.10 (23C) (vi) and (via) -

- (a) applies its income or accumulates it for application, wholly and exclusively to its objects and
- (b) does not invest or deposit its funds otherwise than in anyone or more of the forms or modes specified in S.11(5). There are, however, certain transitional concessions given in this respect

7th proviso lays down that nothing contained in Ss.10(23C) (vi) and (via) shall apply in relation to any income of such educational or medical institution, being profits and gains of **business**, unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business.

Meaning of the expression “Incidental to the attainment of its objectives.”

As already pointed out, as per 7th proviso to S.10(23C), if the income of an educational or medical institution includes income from profits ad gains of business then such business must be incidental to

the attainment of its objectives. There is a similar provision in S.11(4A), which provides that exemption will not be available to any income of a charitable or religious trust / institution from profits

and gains of business, unless the business is incidental to the attainment of the main objects of such trust or institution. In order to clarify the aforesaid concept the following decisions of the Apex Court are quite relevant.

(i) **C.I.T. Vs A. P. State Road Transport Corpn., 159 I.T.R. p.1 (S.C.)**

The relevant part of the Report on p.10 is as follows :

If the predominant object is to carry out a charitable purpose and not to earn profit, the purpose would not lose its charitable character merely because some profit arises from the activity.

(ii) **Aditanar Educational Institution Vs Addl. C.I.T., 224 I.T.R. p.310 (S.C.)**

It was held by the Apex Court in this case that if after meeting the expenditure any surplus results incidentally from the activity lawfully carried on by the educational institution, it will not cease to be one existing solely for educational purposes, since the object is not one to make profit. It was further held that the decisive or acid test is whether, on an overall view of the matter the object is to make profit and in evaluating or appraising the above, one should also bear in mind the distinction / difference between the corpus, the objects and the powers of the concerned entity. (p.318 of the Report)

(iii) **Thiagrajar Charities Vs Addl. C.I.T., 225 I.T.R. p.1010 (S.C.)**

The relevant part of the Report on p.1025 is as follows :

“It is clear that the business of purchasing and selling cotton, cotton yarn, cloth and other fibres, etc., was held under trust ; the said business was started in exercise of the powers vested in the trustees under clause 7(e) read with clause 32 of the resolution dated June 6, 1962, and in view of clause 3 of the deed it is the “corpus” of the trust in reality. It is not an object of the trust. So, it cannot be said that the trust is carrying on (business)- an activity for profit. The business-corporus-property held under trust-produces or results in income, like any other property. That is all. The business is only a “means” of achieving the “object” of the trust ; it is a medium through which the “objects” are accomplished. In this view, the entire approach made by the Appellate Tribunal as also by the High Court fails to give due effect to the trust deed as a whole and is palpably erroneous and the resultant conclusion is vitiated, in denying the exemption to the appellant-trust. We hold accordingly.”

(iv) **Addl. C.I.T. Vs Surat Art. Silk Cloth Mfrs. Asson., 121 I.T.R. p.1.**

The relevant parts of the Report on pp. 25 & 26 are, as follows :

“But where the predominant object of the activity is to carry out the charitable purpose and not to earn profit, it would not lose its character of charitable purpose merely because some profit arises from the activity. The exclusionary clause does not require that the activity must be carried on in such a manner that it does not result in any profit.”

“If the profits must necessarily feed a charitable purpose under the terms of the trust, the mere fact that the activities of the trust yield profit will not alter the charitable character of the trust. The test

now is, more clearly than in the past, the genuineness of the purpose tested by the obligation created to spend the money exclusively or essentially on charity.”

(v) **Sole Trustee, Lok Shikshana Trust Vs C.I.T., 101 I.T.R. p.234 (S.C.)**

The relevant observations of Their Lordships are to be found on p.256, which are reproduced as follows :

“If the profits must necessarily feed a charitable purpose, under the terms of the trust, the mere fact that the activities of the trust yield profit will not alter the charitable character of the trust. The test

now is, more clearly than in the past, the genuineness of the purpose tested by the obligation created to spend the money exclusively or essentially on “charity”. If that obligation is there, the income becomes entitled to exemption. That, in our opinion, is the most reliable test.”

As a summation it can be safely stated that, institutions with philanthropic purposes having an incidental or ancillary business activity that creates profits necessary for achieving the main objects of the institutions, will be entitled to the exemption from income-tax in respect of profits and gains

derived from such business activity. In other words an educational institution will not lose its exemption U/s. 10 (23C) if incidentally it makes some profit in carrying on its main object of promoting education and such profits are applied for such educational objects. Similarly exemption will not be denied to a hospital or a similar medical institution just because some surplus results while providing medical relief. **Thus if the surplus resulting from an activity while pursuing the object of promotion of education or medical relief, is utilised on the aforesaid objects, the institution would be entitled to exemption from income-tax U/s.10(23C) of the I. T. Act.**

3. **A brief summary of the consequences of omission of Ss.10(22) and 10(22A) and amendment of S.10(23C).**

Before the omission of Ss.10(22) and 10(22A) by the Finance (No.2) Act 1998, income of educational and medical institutions was fully exempt from income-tax and such institutions were neither required to file return of income, nor were they required to seek any approval under the Income-Tax Act. In addition, there were no restrictions on the modes of investments of such institutions. Such institutions could invest their funds in any manner, subject to their rules and regulations. As already pointed out, the Finance(No.2) Act 1998, has simultaneously inserted new provisions in S.10(23C) regarding educational and medical institutions. As per these new provisions, the tax treatment of such institutions would be as follows :

(i) **Educational and medical institutions wholly or substantially financed by Government.**

- (a) The income of educational institutions will be fully exempt U/s.10(23C)(iiiab) and the income of medical institutions will be exempt U/s.10(23C)(iiiac).

- (b) The educational institutions should exist solely for educational purposes and not for purposes of profit and the medical institutions should exist solely for philanthropic purposes and not for purposes of profit.
- (c) Such educational or medical institutions will not be required to make any changes in their existing pattern of investment.
- (d) Such institutions need not file any return of income.

(ii) Educational or medical institutions, the annual receipts of which do not exceed the prescribed amount (Annual receipts have been fixed at Rs one crore, vide newly inserted Rule 2-BC)

If the annual receipts of educational or medical institutions do not exceed the prescribed amount, then all the conditions applicable to educational or medical institutions wholly or substantially financed by Government, as mentioned in aforesaid para (i) ; will apply to them.

(iii) Educational or medical institutions approved under Ss.10(23)(vi) and 10(23)(via).

If the educational or medical institutions do not fall in any of the aforementioned two categories, viz. those institutions which are not financed by the Government or which have annual receipts more than the prescribed amount ; they may claim exemption U/s.10(23C). They will, however, be governed by certain conditions which are as follows :

- (a) They will be required to make application to the prescribed authority for obtaining approval under the new S.10(23C)(vi) in case of educational institutions and U/s.10(23C)(via) in case of a medical institutions. The prescribed authority is not yet notified, however, it may be the D.G.(Exemptions).
- (b) The income of such educational or medical institutions will be fully exempt under Ss.10(23C)(vi) and 10(23C)(via) respectively.
- (c) The educational institutions should exist solely for educational purposes whereas the medical institutions should exist solely for philanthropic purposes and they should not exist for purposes of profit.
- (d) Such institutions will be required to change their present modes of investment and bring them in line with the modes of investment as prescribed U/s.11(5).

These institutions will, however, be allowed some transitional period for the aforesaid purpose.

- (e) Separate books of account for income and expenditure will be required to be maintained.
- (f) No return of income need be filed by such institutions.

(iv) Educational or medical institutions not covered under any of the aforesaid three categories.

If the educational or medical institutions are not covered under any of the aforementioned three categories, then they may claim exemption from income-tax under the provisions of Ss.11 and 12 and for claiming such exemptions they will be required to fulfil the following conditions.

- (a) The institution is required to be registered U/s.12A of the Income-Tax Act.
- (b) Separate books of account for income and expenditure will have to be maintained.
- (c) If the annual receipts exceed Rs.50,000/-, their accounts are required to be audited.
- (d) At least 75% of income must be applied towards the objects of the institutions during the previous year.

- (e) The funds of the institution are required to be invested in the modes of investment prescribed U/s.11(5).
- (f) The institution will be required to file its return of income every year.

S. K. TYAGI	☎ Office	: (020) 613 3012	Flat No.2, (First Floor)
M.Sc., LL.B., Advocate	Fax	: (020) 612 1131	Gurudatta Avenue
Ex-Indian Revenue Service	Residence	: (020) 668 2032	Popular Heights Road
Income-Tax Advisor		: (020) 668 2444	Koregaon Park
	E-mail	: sktyagidt@vsnl.com	PUNE - 411 001
