

# Analysis Of Supreme Court Decisions On Charitable Trust & Sec. 45(4)

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# INTRODUCTION

- Law relating to charitable trusts are complex and often unsettled.
- With the passage of time, one feels that most of the issues are covered in respect of a particular topic.
- However this is not true as issues that seem to have been settled by judicial pronouncements are often upset by subsequent decisions.
- Even SC gives a different interpretation to a matter that is already settled by its own earlier decision.
- It is in this context that certain recent rulings become relevant and needs understanding.

# The law relating to taxing of Educational Institutions – a glimpse

- Section 10(22) of the Act was part of the statute right from the enactment of the IT Act, 1961.
- The section provided exemption for any income of a university or other educational institution existing “solely” for educational purposes and not for profit.
- Later on, Section 10(22) was omitted, in the absence of any monitoring mechanism for checking the genuineness of their activities, as the said provision was being misused.

## Contd...

- Thus, Sec. 10(22) was omitted and in its place Sec. 10(23C) was inserted.
- The Finance (No. 2) Act, 1988 while omitting sec. 10(22) of the Act, *inter alia* introduced clauses (iiiab), (iiiad) and (vi) in sec. 10(23C) of the Act.
- Sec. 10(23C)(vi) exempts income of any educational institution and contains several provisos which have been amended from time to time.

# Contd...

- The above section covers “any university or educational institution existing **'solely'** for educational purposes and not for purposes of profit” (Specified Exemption).
- With respect to the Specified Exemption, there has been some jurisprudence as to how to interpret the word *'solely'*.

# Issues

- Whether “solely” means, the educational institution should be exclusively engaged for the purpose of education, or whether only the predominant purpose of the institution should be education (Predominant Test)?
- Based on earlier SC judgements – [*American Hotel and Lodging Association vs CBDT (2008) 301 ITR 86, Queens Education Society vs CIT (2015) 372 ITR 699, ACIT vs Surat Art Silk Cloth Manufacturers Association (1978) 121 ITR 1*] etc. - the prevailing view was that for the purpose of Specified Exemption, the Predominant Test would suffice.

# The New Theory.

- However, in the recent SC judgement *M/s New Noble Educational Society v The Chief Commissioner of Income Tax (448 ITR 594)*, the court has applied principles of literal interpretation and has chosen to ignore the contextual or purposive interpretation of statutes or other aides to discern the true meaning of the phrase “solely”.
- The SC has arrived at the said analogy by construing that the statute is clear and unambiguous. Accordingly, the plain and literal meaning of the phrase “solely” was arrived through dictionary meanings.

# The Case of New Noble Education Society vs CCIT

- Before the Andhra Pradesh High Court, a batch of writ petitions came-up against the rejection of applications of the petitioners for grant of approval u/s 10(23C).
- Directions were sought from the CCIT to grant the requisite approval to the petitioners (societies/trust) from AY 2009-10 onwards.

# The Case of New Noble Education Society vs CCIT

## THE FACTS OF THE CASE

- The Person Authorized (PA) rejected the taxpayer's application for registration under Section 10(23C) of the Act to avail tax exemption as an educational institution.
- The HC confirmed the said action of the tax authorities because the respective institutions were:
  - *Not created solely for education; and*
  - *Not registered under the applicable state laws governing such institutions, which is a pre-requisite for the grant of approval.*

# The Case of New Noble Education Society vs CCIT

- The taxpayer filed an appeal against the order of the HC and raised the following issues before the SC:
  - *What is the meaning of the term 'solely' in the context of educational institutions under Section 10(23C) of the Act.*
  - *For the purpose of tax exemption, what is the correct manner to consider surplus/profits generated by an educational institution.*
  - *Whether the PA is required to satisfy himself of compliance with any other conditions, such as registration of charitable institutions under local or state laws, when the taxpayer is seeking approval.*

# New Noble Education Society vs CCIT

## Contentions of the petitioners:

- Section 10(23C)(vi) makes or distinguishes between the educational institution and the society/trust running it;
- The approval is granted to the educational institution and not to the society/trust;
- It is only the object of educational institution which should be considered and not that of society/trust

# New Noble Education Society vs CCIT

## Contentions of the petitioners:

- The society/trust which runs the educational institution is entitled to pursue other objects other than those relating exclusively for educational purposes;
- The term 'solely' ought to be interpreted liberally and should not be construed in the literal sense.
- To decide if an institution exists solely for educational purposes, the test is whether the 'principal' or 'main' activity was education or not ('predominant test') rather than whether some profits were incidentally earned.

# New Noble Education Society vs CCIT

## Contentions of the petitioners:

- Relying on the case of Queen's Education, the taxpayer argued that the income earned incidentally to the main object per se would not debar the trust's application for approval or registration.
- At the stage of registration (i.e. vetting stage), the PA may only examine the actual existence of the educational institution. Enquiry into the institution's functioning and compliance with other related provisions would be relevant post-grant of approval (i.e., at the assessment stage).

# New Noble Education Society vs CCIT

## Contentions of the Revenue:

- Relied on T.M.A. Pai Foundation - (2002) (8 SCC 481) - it was held that 'education' under the Constitution meant and included education at all levels, from primary school upto postgraduation, including professional education.
- It was argued that the entities claiming exemption should be imparting education itself and may generate surplus during such activity. As per T.M.A. Pai Foundation(supra), education per se is to be regarded as a charitable activity.
- It could not be considered as trade or business with a profit motive driving it. Thus, the commercialization of education would result in the loss of the benefit of tax exemption, which otherwise may be available.

# New Noble Education Society vs CCIT

## Contentions of the Revenue:

- It was immaterial whether the societies/trust pursues all its objects enumerated in its trust deed, even if an object is not pursued in real terms in a year, it can be pursued in other years as it has mandate to do so; such objects of a trust fall foul of the conditions specified in Sec. 10(23C)(vi)
- Exemption is granted to society/trust and not to any of its limb engaged in a particular activity.

# New Noble Education Society vs CCIT

## Contentions of the Revenue:

- It is necessary that all the objects mentioned in the trust deed are exclusively for education and not for any other purpose.
- CBDT in the instruction dated 29<sup>th</sup> October, 1977 had explicitly prohibited spending of surplus of an educational institution for non-educational purposes.
- Even if no amount is spent for non-educational purpose, the society/trust would not be entitled to exemption if its existence is not solely for educational purpose.

# New Noble Education Society vs CCIT

## Observations of the Supreme Court:

- The SC upheld the decision of the HC rejecting the taxpayer's application for approval as an educational institution for the purpose of tax exemption.
- The SC affirmed that in the context of 'charitable activity' under the Act, 'education' means imparting formal scholastic learning.
- SC held that an institution shall be eligible for tax exemption only if its objects are solely concerned with education or education-related activities.

# New Noble Education Society vs CCIT

## Observations of the Supreme Court:

- All objects of the society, trust, etc., must relate to imparting education or be in relation to educational activities, and not engage in any activity of profit.
- Further, it clarified that the term 'solely' is not the same as 'predominant /mainly'. The term 'solely' means to the exclusion of all others.
- The seventh proviso to Sec 10(23C) as well as Sec 11(4A) refers to profits that may be 'incidentally' generated or earned by the charitable institution. The same applies to those institutions which only impart education or are engaged in activities connected to education.

# New Noble Education Society vs CCIT

## Observations of the Supreme Court:

- Where the objective of the institution appears to be profit-oriented, such institution would not be entitled to be approved under Section 10(23C) of the Act.
- At the same time, accrual of surplus in any given year or set of years, per se, is not a bar, provided such surplus is inextricably linked to the providing education or educational activities.
- Further, if profits are generated incidentally, while carrying on the educational or related objectives, such 'business income' may also be tax exempt subject to maintenance of separate books of accounts for such business

# New Noble Education Society vs CCIT

## Observations of the Supreme Court:

- On the powers of PA, SC held that the enquiry may not be restricted only to objects of the institution at the vetting stage.
- PA is free to call for audited accounts or other such records/ documents to determine the genuineness of the institution.
- However, the SC also explained that such enquiry should be confined to understanding the nature of income earned and whether it is from education or education-related objects.
- It observed that disproportionate weight ought not to be given to incidental profits/surplus generated.

# New Noble Education Society vs CCIT

## Observations of the Supreme Court:

- PA should not reject the application merely because of surplus, where the income generating activity is intrinsically a part of the educational objective.
- The SC further observed that registration of the institutions under relevant state laws concerning charitable institutions enables the state to ensure that they are managed efficiently without misfeasance. Thus, compliance with other state laws also legitimately weighs with the PA while deciding on the application and genuineness of the institution.

# New Noble Education Society vs CCIT

## Observations of the Supreme Court:

- Since the present judgement has departed from the previous rulings regarding the meaning of the term 'solely', laws/interpretations declared in the present judgement shall operate prospectively, thereby providing time to other institutions likely to be affected to make appropriate changes and avoid disruptions.

# New Noble Education Society vs CCIT

## Conclusion.....:

- It was held that in cases where the approval, u/s 10(23C)(vi) of the Act is initially sought, the objects in the MOA of a society/ trust are conclusive evidence of such a trust existing solely as educational institution entitled for the benefits and as being eligible for the approval.
- In cases where an application is submitted seeking renewal of the exemption granted earlier, the prescribed authority shall in addition to the conditions aforementioned, also examine whether the income of the applicant society has been applied solely for the purpose of education in terms of sec. 10(23C)(vi) of the Act.

# New Noble Education Society vs CCIT

## Conclusion.....:

- The SC has also cleared the ambiguities surrounding the powers of PA and the scope of enquiry as regards the examination of annual accounts at the vetting stage.
- The ruling emphasized the significance and requirement of registration with the relevant state laws for approval. Thus, compliance with other state laws is a must now for being eligible for tax exemption.

# HARSHIT FOUNDATION vs CIT (2022) 442 ITR 372 (SC)

Section 12AA (2) – “Every order granting or refusing registration under clause (b) of sub-section (1) shall be passed before the expiry of six months from the end of the month in which the application was received under clause (a) or clause (aa) or clause (ab) of sub-section (1) of section 12A.”

## ISSUE

Whether shall be deemed registration if in a case the registration application u/s 12AA is not decided within 6 months?

# HARSHIT FOUNDATION vs CIT (2022) 442 ITR 372 (SC)

- ITAT Lucknow bench vide order dated 28<sup>th</sup> June 2013 had decided that *non disposal of application for registration within a period of 6 months will result in deemed grant of registration u/s 12AA(2) of the Act.*
- On revenue's appeal before the Allahabad HC – it was held that non disposal of application for registration within the period of 6 months as provided u/s 12AA(2) would not result in deemed grant of registration. It followed the full bench decision of the same HC in CIT vs Muzafar Nagar Development Authority 372 ITR 209 (All) (FB).
- The SC found that there is no specific provision in the Act which provides for deemed registration where an application for registration u/s 12AA(2) is not decided within 6 months.

# CIT(E) vs MATA AMRITANANTAMAYI MATH 256 Taxmann 62

- Assessee claimed exemption u/s 11(1)(d) in respect of interest earned on corpus funds treating the same as corpus funds itself, based on donors instructions that interest would also form part of the corpus donation.
- AO rejected the claim of the assessee for exemption.
- ITAT allowed the assessee's claim which was confirmed by the Hon. HC.
- The departments SLP filed against the HC order was dismissed by the SC thereby stamping its approval that interest on corpus funds with specific direction from the donors constituted corpus donation itself.

# Section 45(4) of the IT Act

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# INTRODUCTION

- Sec 45(4) of the IT Act was a highly debatable area.

## -Sec 45(4) of the IT Act before amendment

-The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the **dissolution of a firm** or

--other association of persons or

-Body of individuals (not being a company or a co-operative society) or

**-Otherwise,**

-shall be chargeable to tax as the income of the firm, association or body, of the PY in which the said transfer takes place and

-for the purposes of Sec 48, the FMV of the asset on the date of such transfer shall be deemed to be the full value of the consideration received/accruing as a result of the transfer.

# Contd...

- Recently, the Hon. SC in the case of CIT vs Mansukh Dyeing and Printing Mills (CA No. 8258 of 2022) has upset many of the rulings of the HCs and has probably reversed the otherwise settled proposition as far as retirement or change in constitution of a partnership firm is concerned.
  
- The law relating to revaluation of fixed assets and consequential credit to partners' capital account was more or less settled until the pronouncement of the above decision.
  
- Sec 45(4) was introduced into the statute and simultaneously Sec 2(47)(ii) was omitted.

# Contd...

- The omitted Sec 47(ii) excluded distribution of capital assets from the ambit of "transfer".
- This helped the assesseees in avoiding capital gains by revaluing the assets and then transferring and distributing the same.
- This led to a lot of litigation. Most of the decisions were in favour of the assesseees as the acid test for transfer often failed.
- Revaluation of assets and crediting the partners' account often went untaxed as the courts were rightly (as understood then) taking the view that there is no transfer involved on revaluation of assets.
- The intention behind the newly inserted Sec 45(4) was to plug this loophole. Distribution of capital asset to partners' capital account is deemed to be transfer of capital assets and therefore assessable as capital gains in the hands of the firm.

# CIT vs Mansukh Dyeing and Printing Mills

## Facts of the Case:

- The respondent assessee, a partnership firm originally consisted of four partners (all brothers) engaged in the business of Dyeing and Printing, Processing, Manufacturing and Trading in Clothing.
- On 01.11.1992, the firm was again reconstituted and three more partners, namely, viz., Smt. Vaishali Shah (18%), Smt. Bhavna Doshi (9%), Smt. Rupal Doshi (9%) and M/s. Ranjana Textile Pvt. Ltd. (10%) were admitted as partners.

# CIT vs Mansukh Dyeing and Printing Mills

## Facts of the Case:

- It was mentioned in the reconstituted partnership deed that two partners, namely, viz., Shri Hasmukh H. Doshi and Smt. Ranjan Doshi had decided to withdraw part of their capital.
- On 01.01.1993, the assets of the firm were revalued and an amount of Rs. 17.34 crores were credited to the accounts of the partners in their profit-sharing ratio.

# CIT vs Mansukh Dyeing and Printing Mills

## Facts of the Case:

- Two of the existing partners, viz., namely Shri Hasmukhlal H. Doshi & Smt. Ranjan Doshi withdrew part of their capital which was roughly Rs. 20 to Rs. 25 lakhs.
- Thus, according to the Revenue, the new partners were immediately benefited by the credit to their capital accounts of the revaluation amount which are:
  - (i) 3.12 crores were credited to Smt. Vaishali Shah (who contributed Rs. 4.50 lakhs);

# CIT vs Mansukh Dyeing and Printing Mills

## Facts of the Case:

- (ii) 1.56 crores to Smt. Bhavna Doshi (who contributed Rs. 2.25 lakhs);
  - (iii) 1.56 crores to Smt. Rupal Doshi (who contributed Rs. 2.25 lakhs); and
  - (iv) 1.73 crores to M/s. Ranjana Textiles (who contributed Rs. 2.50 lakhs only)
- The assessment was reassessed under Section 143(3) rws 147 determining the total income of Rs. 2,55,19,490/-. Addition of Rs. 17,34,86,772/- was made towards short term capital gains under Sec 45(4) of the Act. Similar addition was made for A.Y. 1994-1995.

# CIT vs Mansukh Dyeing and Printing Mills

## Facts of the Case:

- The CIT(A) by order dated 30.07.2004 confirmed the addition on account of Short-Term Capital Gains and held that there is a clear distribution of assets.
- According to CIT(A), value of assets of the firm which belonged to all the partners of the partnership have been transferred in their profit sharing ratio to each partner.
- The partnership has effectively relinquished its interest in the assets and such relinquishment can only be regarded as transfer.

# CIT vs Mansukh Dyeing and Printing Mills

- Therefore, according to the CIT(A), conditions of Sec 45(4) are satisfied and therefore, the assets to the extent of their value distributed would be deemed as income by capital gains in the hands of the assessee firm.

# CIT vs Mansukh Dyeing and Printing Mills

## ITAT Observations:

- The ITAT observed and held that the decision of the Bombay HC in the case of A.N. Naik Associates and Ors 265 ITR 346. shall not be applicable and held that the decision of the Bombay HC in the case of Texspin Engg. and Mfg. Works 263 ITR 345, Mumbai shall be applicable.

# CIT vs Mansukh Dyeing and Printing Mills

## HC Observations:

- Relying upon the decision of the jurisdictional Court in the case of Hind Construction Ltd., the High Court dismissed the appeals preferred by the Revenue.
- The matter was taken to the SC by the revenue.

# CIT vs Mansukh Dyeing and Printing Mills

## Revenue's Arguments:

- In the case of A.N. Naik Associates and Ors., (supra), the Bombay High Court has interpreted the words "otherwise" used in Section 45(4) of the Income Tax Act and has observed and held that the word "otherwise" used in Section 45(4) takes into its sweep not only cases of dissolution but also cases of subsisting partners of a partnership, transferring assets in favour of a retiring partner.

# CIT vs Mansukh Dyeing and Printing Mills

## Respondent's Arguments:

- There was no dissolution of partnership firm and/or revaluation on dissolution of the partnership firm.
- In the present case, there was reconstitution of the partnership firm and on revaluation, the surplus amount on account of such revaluation was credited to the partners' capital account.

# CIT vs Mansukh Dyeing and Printing Mills

## Respondent's Arguments:

- The surplus on account of such revaluation credited to the partners' capital account cannot be said to be transfer as per the provisions of Sec 45(4) of the Act.

- As per the provisions of Sec 45(4) of the Act, two conditions were required to be fulfilled:

Firstly, there must be a transfer by way of distribution of capital assets,

Secondly, that, such transfer should be either on account of dissolution of partnership firm or otherwise.

# CIT vs Mansukh Dyeing and Printing Mills

## Respondent's Arguments:

- The surplus on revaluation of assets was notionally credited to the partners' capital account of all the partners.
- As rightly observed and held by the ITAT and confirmed by the Hon. HC, it was not a case of transfer/deemed transfer u/s 45(4) of the Act and therefore, both, the ITAT as well as the HC have rightly deleted the addition made towards the short-term capital gains.
- It was submitted that there can be no income just on account of revaluation of capital asset unless the capital asset is also transferred.

# CIT vs Mansukh Dyeing and Printing Mills

## Respondent's Arguments:

- This is only notional or book entry which is not represented by any additional tangible asset or income.
- It was also submitted that once it is established that:  
there is no profit or gain accruing to firm on revaluation resulting in real income,  
there can also be no distribution of such profits and gains and  
therefore, the same cannot be added in the income of the partnership firm as capital gains.

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- The object and purpose of introduction of Sec 45(4) was to plug the loophole by insertion of Sec 45(4) and omission of Sec 2(47)(ii).
- While introduction to Sec 45(4), clause (ii) of Sec 2(47) came to be omitted.
- Earlier, omission of Clause (ii) of Section 2(47) and Section 47(ii) exempted the transfer by way of distribution of capital assets from the ambit of the definition of "transfer".

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- The same helped the assessee in avoiding the levy of capital gains tax by revaluing the assets and then transferring and distributing the same at the time of dissolution.
- At this stage, it is required to be noted that the word used "OR OTHERWISE" in Section 45(4) is very important.

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- In view of the amended Section 45(4) of the Income Tax Act inserted vide Finance Act, 1987, by which, "OR OTHERWISE" is specifically added, the aforesaid submission on behalf of the assessee has no substance.
- The Bombay High Court in the case of A.N. Naik Associates and Ors., had an occasion to elaborately consider the word "OTHERWISE" used in Section 45(4).

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- After detailed analysis of Section 45(4), it is observed and held that the word "OTHERWISE" used in Section 45(4) takes into its sweep not only the cases of dissolution but also cases of subsisting partners of a partnership, transferring the assets in favour of a retiring partner.

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- In the present case, the assets of the partnership firm were revalued to increase the value by an amount of Rs. 17.34 crores on 01.01.1993 (relevant to A.Y. 1993-1994) and the revalued amount was credited to the accounts of the partners in their profit-sharing ratio.
- The credit of the assets' revaluation amount to the capital accounts of the partners can be said to be in effect distribution of the assets valued at Rs. 17.34 crores to the partners

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- During the years, some new partners came to be inducted by introduction of small amounts of capital ranging between Rs. 2.5 to 4.5 lakhs.
- The said newly inducted partners had huge credits to their capital accounts immediately after joining the partnership, which amount was available to the partners for withdrawal and in fact some of the partners withdrew the amount credited in their capital accounts.

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- Therefore, the assets so revalued and the credit into the capital accounts of the respective partners can be said to be “transfer” and which fall in the category of “OTHERWISE” and therefore, the provision of Section 45(4) inserted by Finance Act, 1987 w.e.f. 01.04.1988 shall be applicable.

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- Now, so far as the reliance placed upon the decision of this Court in the case of Hind Construction Ltd. is concerned, at the outset, it is required to be noted that the said decision was pre-insertion of Sec 45(4) of the Act inserted by Finance Act, 1987 and in the earlier regime – pre-insertion of Sec 45(4), the word “OTHERWISE” was absent.

# CIT vs Mansukh Dyeing and Printing Mills

## Supreme Court Observations:

- Therefore, in the case of Hind Construction Ltd., this Court had no occasion to consider the amended / inserted Sec 45(4) of the Act and the word used "OTHERWISE".
- Under the circumstances, for the purpose of interpretation of Sec 45(4), the decision in the case of Hind Construction Ltd. shall not be applicable and/or the same shall not be of any assistance to the assessee.

# CIT vs Mansukh Dyeing and Printing Mills

## Conclusion:

In view of the above and for the reasons stated above, the impugned judgment and order passed by the HC and that of the ITAT are unsustainable and the same deserves to be quashed and set aside and are accordingly quashed and set aside. The order passed by the Assessing Officer is hereby restored.

A dark, top-down view of a desk. In the upper left, a portion of a laptop is visible, showing its keyboard and trackpad. Below the laptop, a tablet or laptop lid is open, showing a blank screen. In the center, a dark coffee cup sits on a matching saucer. The background is a dark, textured surface.

**THANK YOU!**



Q&A

