Maintenance fee received from ‘satellite schools’ is incidental to the charitable purpose of education: Delhi HC

Summary

Delhi High Court (HC), in a recent ruling[1], has held that maintaining satellite schools in furtherance of the education joint venture agreements with an ‘educational purpose’ qualifies as a ‘charitable purpose’ under the Income-tax Act, 1961 (Act). The HC also stated that relevant provisions ought to be interpreted meticulously, on a case-to-case basis and at the same time it needs to be ensured that the purpose, for which such provisions were introduced, is adequately fulfilled.

Facts of the case

- The DPS Society (the taxpayer) has established 11 schools and has also permitted societies/ organisations/ trusts with similar objects to open schools under the name of ‘Delhi Public School’, in and outside India.
- The taxpayer received maintenance charges from around 120 schools vide an ‘education joint venture agreement’ (‘agreement’) where parties jointly agreed to manage the school. Significant say and control in the management of these schools remained with the taxpayer.
- The taxpayer contended that maintenance charges received are towards a number of obligations discharged by it in the course of imparting education and not a fee for franchise of its name and logo.
- Taxpayer submitted that the two conditions to be fulfilled for availing exemption under the Act had been met, i.e., any business activity if carried out by the educational institution should be incidental to their educational purpose and proper accounts of such business activity ought to be maintained.

[1] Director of Income-tax (Exemption) vs. Delhi Public School Society (2018) 92 taxmann.com 132 (Delhi)

- The taxpayer submitted that even if the activity of entering into agreement with the schools was to be construed as business activity, it was incidental to the attainment of its object. Accordingly, it would be entitled to exemption under the Act considering that the receipts from such activity were ploughed back for pursuing the objects of the taxpayer.
- Additional Director of Income-tax (the tax officer), on the other hand, submitted that the franchise fee received from the satellite schools was in lieu of its name, logo and motto which amounted to a 'business activity' with a profit motive. The tax officer also alleged that certain clauses of the taxpayer's Memorandum of Association (MOA) were not in conformity with its objectives.
- The tax officer thus held that the activity of charging franchisee fee could not be regarded as charitable activity within the meaning of relevant provision[2] of the Act and the taxpayer was not entitled to benefit under the Act. It was held that such income was chargeable to tax at the maximum marginal rate.
- The taxpayer's submissions were upheld by the ITAT.

HC ruling

- HC applied predominant object test as laid down by the Apex Court[3]. The HC stated that a distinction is required to be drawn between the institutions working 'for profit' and the institutions 'incidentally earning profit' while carrying on an activity which is predominantly charitable.
- HC upheld ITAT's observation that separate books of accounts as required under the Act were maintained by the taxpayer in form of 'Secretary Office' account.
- HC acknowledged that the MOA of taxpayer as well as the joint venture agreements entered into with the satellite schools validate the motive of an educational purpose that the taxpayer aims through its business activities.
- HC stated that surplus (profit) arising from an activity does not automatically presuppose a business activity that invalidates the exemption under the Act. It has to be tested on whether such profits are being utilised within the meaning of the larger charitable purpose as defined in the Act or not.
- Based on aforesaid observations, HC concluded that the taxpayer fulfilled the requirements under the Act to qualify for exemption.

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[2] Section 2(15) of the Act

[3] Queen's Educational Society vs. CIT (2015) 372 ITR 699 (SC)

Our comments

This ruling of the HC is in line with previous judicial pronouncements offering relief to the taxpayers engaged in charitable activities who have been denied the benefit on account of earning certain surplus during the course of their activities. Taxpayers engaged in similar activities ought to exercise caution while drafting agreements to clearly retain focus on the charitable object and link the remuneration to furtherance of such object.