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WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provided dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

TAX ON EDUCATIONAL INSTITUTIONS: RELAXATION UNDER INCOME TAX ACT, 1961 AND IMPACT OF NEW NOBLE EDUCATIONAL SOCIETY'S JUDGEMENT

AUTHORED BY - DR. SYED MOHAMMAD YAWAR¹

Abstract

Education is the key that unlocks the golden door to freedom. The law of taxation provides that the institutions which runs solely the educational objectives should be relaxed from paying the income tax. The purpose of this provision is to promote education and educational institutions in India. The problem arises when an institution or trust or society have other objects also or have profits out of that objective of imparting education. Then the question arises what would be the approach for taxing those institutions or trusts of societies. This paper tries to analyse these issues along with the recent landmark judgement of the Supreme Court in *New Noble Educational Society v. The Chief Commissioner of Income Tax* which not only considered all these issues but also resolved many of these legal questions.

Keywords: Tax, Education, Educational Institution.

Introduction

It is being universally considered that education is one of the most important aspects of human life. Taxation on education is a contested phenomenon which one hand requires that the education should serve the purposes of the society and on the other hand it requires that the tax should be taken from all persons of the nation so that it can help in nation building. This pertinent issue came for consideration in the Supreme Court of India in *New Noble Educational Society v. The Chief Commissioner of Income Tax*²

The subject matter of this case was the registration of *New Noble Educational Society* under Income Tax Act of educational institution. Section 10 (23C) of the income Tax Act provides under

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² 2023 6SCC 649

clause (vi) that any income of any university or other educational institution existing solely for educational purposes and not for purposes of profit, other than those mentioned in sub-clause (iiiab)³ or sub-clause (iiiad)⁴ and which may be approved by the Principal Commissioner or Commissioner shall not be taxed. Andhra high Court held that the appellant society was not created solely for the purposes of education.⁵ Appellants were denied registration on the ground that they were not registered under the Andhra Pradesh Charitable and Hindu Religious Institutions and Endowments Act, 1987 (“A.P. Charities Act”) as condition precedent for grant of approval.

The parties had urged that such a precondition was absent in the provisos to Section 10(23C) (vi) of the IT Act, and that since the tax statute was a complete code in itself, other acts such as A.P. Charities Act could not form the basis for denying approval. High court rejected this contention on the basis of the judgement of the Supreme Court in *M/s New Noble Educational Society v The Chief Commissioner of Income Tax*⁶.

In *CIT v. Sorabji Nusserwanji Parekh*⁷ it was held that, ‘In order to be eligible for exemption, under section 10(23C) (vi) of the Act, it is necessary that there must exist an educational institution. Secondly, such institution must exist solely for educational purposes and, thirdly, the institution should not exist for the purpose of profit.’⁸ The Court held that, “the emphasis in section 10(23C) (vi) is on the word “solely”. “Solely” means exclusively and not primarily”.⁹

On the question of Compulsory registration Court quoted that, As “education” falls within the scope of “charitable purpose” both under section 2(5) of A.P. Act 30 of 1987 and section 2(15) of the Income tax Act and, inasmuch as A.P. Act 30 of 1987 requires all charitable institutions in the State of A.P. to be registered, the Chief Commissioner was justified in holding that the petitioner-societies should have registered themselves under the provisions of A.P. Act 30 of 1987, as failure

³ (iiiab) any university or other educational institution existing solely for educational purposes and not for purposes of profit, and which is wholly or substantially financed by the Government

⁴ (iiiad) any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of the person from such university or universities or educational institution or educational institutions do not exceed five crore rupees; or

⁵ *M/s New Noble Educational Society v The Chief Commissioner of Income Tax*, (2011) 334 ITR 303

⁶ (2011) 334 ITR 303

⁷ [1993] 201 ITR 939 (Guj)

⁸ *Supra* Note 5 Para 8.

⁹ *CIT v. Gurukul Ghatkeswar Trust*, (2011) 332 ITR 611 (AP); *CIT v. Maharaja Sawai Mansinghji Museum Trust*, [1988] 169 ITR 379 (Raj)

to so hold would have resulted in one arm of the law being utilized to defeat another arm of the law which would not only be opposed to public policy, but would also bring the law into ridicule. (Bihari Lal Jaiswal v. CIT, [1996] 217 ITR 746 (SC)).”¹⁰

In this judgement the Court reached on conclusion that Education enables the mind and refines the sensibilities of every human being. It aims to train individuals to make the right choices. Its primary purpose is to liberate human beings from the thrall of habits and preconceived attitudes. It should be used to promote humanity and universal brotherhood. By removing the darkness of ignorance, education helps us discern between right and wrong. There is scarcely any generation that has not extolled the virtues of education, and sought to increase knowledge.¹¹

The issues which require resolution in these cases are firstly, the correct meaning of the term ‘solely’ in Section 10 (23C) (vi) which exempts income of “university or other educational institution existing solely for educational purposes and not for purposes of profit”. Secondly, the proper manner in considering any gains, surpluses or profits, when such receipts accrue to an educational institution, i.e., their treatment for the purposes of assessment, and thirdly, in addition to the claim of a given institution to exemption on the ground that it actually exists to impart education, in law, whether the concerned tax authorities require satisfaction of any other conditions, such as registration of charitable institutions, under local or state laws.¹²

The Appellants contended that the impugned judgment was in error of the law. They contended that the High Court’s approach in considering the memorandum of association, rules or the constitution of the trust was no doubt correct, however the literal interpretation of the expression ‘solely’ under Section 10(23C) (vi) was not correct.

The Court identified mainly three issues involved in this case:

1. The *correct meaning of the term ‘solely’* in Section 10 (23C) (vi) which exempts income of “university or other educational institution existing solely for educational purposes and not for purposes of profit”.

¹⁰ *Supra* Note 5 Para 23 Quoting Para 23.

¹¹ *New Noble Educational Society v. The Chief Commissioner of Income Tax* 2023 6SCC 649 Para 32.

¹² *Ibid* Para 34.

2. The proper manner in considering any gains, surpluses or profits, when such receipts accrue to an educational institution, i.e., *their treatment for the purposes of assessment*, and;
3. In addition to the claim of a given institution to exemption on the ground that it actually exists to impart education, in law, whether the concerned tax authorities require satisfaction of any other conditions, such as *registration of charitable institutions*, under local or state laws.¹³ (emphasis supplied)

The Court held with regard to first issue that both the parties have their claims argued on the point. It is emphasized by respondent that though there are several heads of charity and several kinds of organizations which are recognised by the IT Act, the statute underlines that those which claim to be educational institutions should have only the sole object of education, and no other. On the other hand, the assessee appellants contend that the expression ‘solely’ has never been understood in its literal sense, but that this court has consistently held that the expression means that the predominant object, among other objects of the institution claiming exemption, should be education.¹⁴

Before the advent of the IT Act, under the old Income Tax Act, 1922, charitable purposes – much like the present one - included four broad heads. The last head was advancement of objects of general public utility. The court had to deal with the changed definition, brought about by the IT Act of 1961, which contained restrictive terms, in that the making of profit in the course of carrying on of objects of general public utility was prohibited. In a couple of decisions of Supreme Court, it was held that the prohibition against making profit applied only to trusts that had as their objective the advancement of general public utility. The prohibition from making profits therefore, did not apply to trusts meant to advance education, medical relief or relief for the poor.¹⁵

Citing the example of *Indian Chamber of Commerce v Commissioner of Income Tax*¹⁶ the Supreme Court held that, “This court was of the opinion that the principal object, or in the exact words of the decision, ‘the predominant’ object or purpose of the assessee was to advance the interests of silk manufacturers. The other objects were only *incidental*. It was in that context that the court held that *profit-making in the course of carrying on the predominant objective of a trust*

¹³ *Supra* Note 11 para 34

¹⁴ *Ibid* Para 35.

¹⁵ *Supra* Note 11 Para 37.

¹⁶ (1976) 1 SCC 324.

or other institution is not per se prohibited.”¹⁷ (emphasis supplied)

‘Predominant Object’ Test

The Court observed that it is evident that the seeds of the ‘predominant object’ test was evolved for the first time in *Surat Art*¹⁸. Noticeably, however, *Surat Art*¹⁹ was rendered in the context of a body claiming to be a *charity*, as it had advancement of *general public utility* for its objects. It was *not rendered in the context of an educational institution*, which at that stage was covered by Section 10 (22). In that sense, the court had *no occasion* to deal with the term ‘educational institution, existing solely for educational purposes and not for purposes of profit’. Therefore, the application of the ‘predominant object’ test was *clearly inapt* in the context of charities set up for advancing education.²⁰ The reliance was also placed by Court on *Aditanar Educational Institution v. Additional Commissioner of Income Tax*²¹ in which the issue was whether the assessee society, whose objects were education, could be denied exemption, on the ground that it was not engaged in educational activities, but its schools were. The Income Tax Appellate Tribunal and the High Court granted relief on that score, holding that the assessee’s objects were ‘solely’ educational.²² (emphasis supplied)

In *Oxford University Press v. CIT*²³ Justice Y.K. Sabharwal opined that, “The requirement of existing university solely for educational purposes and not for purposes of profit will also be applicable to the universities and to this extent I am in respectful agreement with the reasoning of brother Mohapatra. For the present purposes, however, as already said, I will assume that sole purpose of University of Oxford is educational and not profit...”

“...A university or other educational institution which exists solely for educational purposes and not for purposes of profit though not established in India but having some educational activity in this country alone would be entitled to claim exemption. Such a university or educational institution having educational activity in India but being established or constituted in some other country would not be denied the benefit of exemption only on the ground that it has not been established or constituted in India.”²⁴

¹⁷ *Supra* Note 11 Para 38.

¹⁸ *Additional Commissioner of Income Tax v. Surat Art Silk Cloth Manufacturers’ Association*, (1980)2 SCC 31.

¹⁹ *Ibid*.

²⁰ *Supra* Note 11 Para 39.

²¹ (1997) 3 SCC 346

²² *Supra* Note 11 Para 40.

²³ [2001] 247 ITR 658 (SC)

²⁴ *Ibid* Para 42

Nature of Activity Test

In *American Hotel and Lodging Association v Central Board of Direct Taxes*²⁵ Supreme Court held that, “In deciding the character of the recipient, it is not necessary to look at the profits of each year, but to consider the nature of the activities undertaken in India. *If the Indian activity has no co-relation to education, exemption has to be denied*²⁶. Therefore, the character of the recipient of income must have character of educational institution in India to be ascertained from the nature of the activities, if after meeting expenditure, surplus remains incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes. In other words, *existence of surplus from the activity will not mean absence of educational purpose*²⁷. The test is the *nature of activity*. If the activity like running a printing press takes place it is not educational. But whether the income/profit has been applied for non-educational purpose has to be decided only at the end of the financial year” (emphasis supplied) In *Queen’s Education Society v Commissioner of Income Tax*²⁸ Supreme Court affirmed the ‘*Predominant Object Test*’ and observed that, “Thus, the law common to Section 10 (23C) (iiiad) and (vi) may be summed up as follows:

- (1) Where an educational institution carries on the activity of education primarily for educating persons, *the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes* and becomes an institution for the purpose of making profit.
- (2) The *predominant object test* must be applied - the purpose of education should not be submerged by a profit-making motive.
- (3) A distinction must be drawn between the making of a surplus and an institution being carried on "for profit". No inference arises that *merely because imparting education results in making a profit, it becomes an activity for profit*.
- (4) If after meeting expenditure, *a surplus arises incidentally* from the activity carried on by the educational institution, it will not be cease to be one existing solely for educational purposes.

²⁵ (2008) 10 SCC 509

²⁶ *Oxford University Press, Supra* Note 23

²⁷ *Aditanar, Supra* Note 21

²⁸ (2015) 8 SCC 47.

- (5) *The ultimate test is whether on an overall view of the matter in the concerned assessment year the object is to make profit as opposed to educating persons.*²⁹ (emphasis supplied)

Supreme Court concluded the doctrinal part of this discussion in the following manner, “From the above discussion, it is evident that this court has spelt out the following to be considered by the revenue, when trusts or societies apply for registration or approval on the ground that they are engaged in or involved in education:

- (i) As long as the sole object of the society or trust is to impart education, the fact that it does not do so itself, but its colleges or schools do so, does not result in rejection of its claim.³⁰
- (ii) To determine whether an institution is engaging in education or not, the court has to consider its objects.³¹
- (iii) The applicant institution should be engaged in imparting education, if it claims to be part of an entity or university engaged in education.³²
- (iv) The ‘predominant object’ has to be considered to know whether the applicant’s claim for exemption can be allowed.³³
- (v) The mere fact that substantial surpluses or profits were generated could not be a bar for rejecting the application for approval³⁴ under Section 10(23C) (vi) of the IT Act.³⁵

***American Hotel*³⁶ and *Queens Education Society*³⁷ Overruled**

In the light of the above discussion, the court was of the opinion that the interpretation adopted by the judgments in *American Hotel* (supra) as well as *Queens Education Society* (supra) as to the meaning of the expression ‘solely’ are erroneous. The trust or educational institution, which seeks

²⁹ *Supra* Note 28 Para 11

³⁰ *Aditanar Educational Institution v. Additional Commissioner of Income Tax* (1997) 3 SCC 346.

³¹ *Ibid.*

³² This condition was propounded in *Oxford University Press v. CIT* [2001] 247 ITR 658 (SC) where the applicant was a publisher, part of the Oxford University established in the U.K. The assessee did not engage in imparting education, but only in publishing books, periodicals, etc. for profit. Therefore, the court by its majority opinion held that the mere fact that it was part of a university (incorporated or set up abroad) did not entitle it to claim exemption on the ground that it was imparting education in India.

³³ *American Hotel and Lodging Association v Central Board of Direct Taxes* (2008) 10 SCC 509. It was also held that the stage of examining whether and to what extent profits were generated and how they were utilised was not essential at the time of grant of approval, but rather formed part of the monitoring mechanism.

³⁴ *Queen’s Education Society v. Commissioner of Income Tax* (2015) 8 SCC 47.

³⁵ *Supra* Note 11 Para 48.

³⁶ *Supra* Note 33

³⁷ *Supra* Note 34

approval or exemption, should solely be concerned with education, or education related activities. If, incidentally, while carrying on those objectives, the trust earns profits, it has to maintain separate books of account. It is only in those circumstances that 'business' income can be permitted- provided, as stated earlier, that the activity is education, or relating to education. The Court went on to decide that judgments in *American Hotel* (supra) as well as *Queens Education Society* (supra) do not state the correct law, and were accordingly overruled.³⁸

Examination of Nature of Activity for the Purpose of Registration

The second question which the court had to address was whether the Commissioner or any other designated authority is in any manner enjoined to confine the nature of inquiry to discern the object of a society, trust or other institution at the stage when it approaches the authority for approval under Section 10 (23C).

The court was of the opinion that the Commissioner or the concerned authority, while considering an application for approval and the further material called for (including audited statements), should confine the inquiry ordinarily to the nature of the income earned and whether it is for education or education related objects of the society (or trust). If the surplus or profits are generated in the hands of the assessee applicant in the imparting of education or related activities, disproportionate weight ought not be given to surpluses or profits, provided they are incidental. At the stage of registration or approval therefore focus is on the activity and not the proportion of income. If the income generating activity is intrinsically part of education, the Commissioner or other authority may not on that basis alone reject the application.³⁹

Compliance Under Other Laws Compulsory as well as Relevant Consideration

The requirement of registration of every charitable institution is not optional. Aside from the fact that the consequences of non-registration are penal, which indicates the mandatory nature of the provisions of the A.P. Charities Act, such local laws provide the regulatory framework by which

³⁸ *Supra* Note 11 Para 60.

³⁹ *Supra* Note 11 Para 63.

annual accounts, manner of choosing the governing body (in terms of the founding instrument: trust, society, etc.), acquisition and disposal of properties, etc. are constantly monitored.⁴⁰

It was also held that charitable institutions and societies, which may be regulated by other state laws, have to comply with them just as in the case of laws regulating education (at all levels). Compliance with or registration under those laws, are also a relevant consideration which can legitimately weigh with the Commissioner or other concerned authority, while deciding applications for approval under Section 10 (23C).⁴¹

Conclusion

The judgement of Hon'ble Supreme Court of India in *New Noble Educational Society v. The Chief Commissioner of Income Tax* is not only important from the perspective of Taxation Law in India but it also provided the solution of various problems and doubts relating to taxation of charitable institute imparting education.

Meaning of Solely: 'Solely' means exclusively and not primarily':

The Supreme Court in this case cleared the doubt and held that the requirement of the charitable institution, society or trust etc., to 'solely' engage itself in education or educational activities, and not engage in any activity of profit, means that such institutions cannot have objects which are *unrelated to education*. In other words, all objects of the society, trust etc., must relate to imparting education or be in relation to educational activities. The reasoning and conclusions in *American Hotel* (supra) and *Queen's Education Society* (supra) so far as they pertain to the interpretation of expression 'solely' were disapproved and those judgements got *overruled* to that extent.

Condition for approval under Section 10(23C) of the IT Act:

In this case on the question of approval also the Supreme Court cleared the grey area by holding that *where the objective of the institution appears to be profit-oriented, such institutions would not be entitled to approval under Section 10(23C) of the IT Act*. At the same time, where surplus accrues in a given year or set of years per se, it is not a bar, provided such surplus is generated *in the course of providing education or educational activities*.

Meaning of Incidental Business or Profit:

⁴⁰ *Ibid* Para 69.

⁴¹ *Ibid* Para 70.

On the point of profits which might generate incidentally the Court was of the view that, ‘the seventh proviso to Section 10(23C), as well as Section 11(4A) refer to profits which may be ‘*incidentally*’ generated or earned by the charitable institution. In the present case, the same is applicable only to those institutions which impart education or are engaged in activities connected to education’.

The correct meaning of incidental business or profit was explained by the Court. Court held that the reference to ‘business’ and ‘profits’ in the seventh proviso to Section 10(23C) and Section 11(4A) *merely means that the profits of business which is ‘incidental’ to educational activity* i.e., relating to education such as sale of text books, providing school bus facilities, hostel facilities, etc.

Can Concerned Authority Seek Documents to Ascertain the Objects Society/Trust/Institution?

While considering applications for approval under Section 10(23C), the Commissioner or the concerned authority as the case may be under the second proviso *is not bound to examine only the objects of the institution*. To ascertain the genuineness of the institution and the manner of its functioning, the Commissioner or other authority is free to call for the audited accounts or other such documents for recording satisfaction where the society, trust or institution genuinely seeks to achieve the objects which it professes. The observations made in *American Hotel* (supra) suggest that the Commissioner could not call for the records and that the examination of such accounts would be at the stage of assessment. Whilst that reasoning undoubtedly applies to newly set up charities, trusts etc. the proviso under Section 10(23C) is not confined to newly set up trusts – it also applies to existing ones. *The Commissioner or other authority is not in any manner constrained from examining accounts and other related documents to see the pattern of income and expenditure*.

Registration under relevant law compulsory:

Wherever registration of trust or charities is obligatory under state or local laws, the concerned trust, society, other institution etc. seeking approval under Section 10(23C) should also comply with provisions of such state laws. This would enable the Commissioner or concerned authority to ascertain the genuineness of the trust, society etc. This reasoning is reinforced by the recent

insertion of another proviso of Section 10(23C) with effect from 01.04.2021.⁴² (emphasis supplied)

The decision cleared many doubts on the point of taxation of the Institutions existing solely for educational purposes. The relaxation of tax should not be denied to those institutions which impart education as this is the policy of the legislature and those institutions who want only the relaxation in tax in the name of education should be taxed. The purpose of the law as well as the judicial precedent is to empower educational institutions financially by not collecting tax from them while clipping the wings of the mischievous elements who tries to veil their actions under this exception of the Income tax Act.

⁴² *New Noble Educational Society v. The Chief Commissioner of Income Tax* 2023 6SCC 649 Para 76.