

Commissioner of Income-Tax, Kerala

Vs

Dharmodayam Co.

Civil Appeals Nos. 1521-1523 of 1973

(Y. V. Chandrachud, P. S. Kailasam JJ)

22.08.1977.

JUDGMENT

CHANDRACHUD J. -

The assessee in these appeals is a company which was registered under the Cochin Companies Act and later under the Indian Companies Act, 1956. The sources of income of the assessee are interest on securities, income from property and kuries or chit funds. For the assessment years 1952-53 to 1956-57, in making its returns of income, the assessee did not show the income from kuries on the ground that it was exempt under section 4 (3) (i) of the Indian Income-tax Act, 1922, and that the proviso to that section had no application as the business of kuries was not carried on "on behalf of a religious or charitable institution" but was the trust business of the assessee itself. This contention was rejected by the Income-tax Officer, the Appellate Assistant Commissioner and the Appellate Tribunal but, on a reference under section 66 (1) of the Act of 1922, the High Court of Kerala in *Dharmodayam Co. v. Commissioner of Income-tax* [1962] 45 ITR 478 held that the business of kuries was itself held by the assessee under a trust for religious or charitable purposes and that it could not be said that the business was conducted "on behalf of" the religious or charitable institution. Therefore, according to the Division Bench which decided that case, the proviso to section 4 (3) (i) was not attracted and the income from kuries in so far as it was applied for religious or charitable purposes was exempt from tax. The revenue brought the matter in appeal to this court but it withdrew the appeal with the result that the decision of the High Court became final.

The instant case arose after the Income-tax Act of 1961 came into force, the assessment year being 1968-69. The Income-tax Officer declined to grant exemption in respect of the income derived by the assessee from its kuri business but that order was set aside by the Appellate Assistant Commissioner whose judgment was confirmed by the Appellate Tribunal. These two authorities held that despite the amendment introduced by the Act of 1961 in section 2 (15), the earlier decision would apply and the assessee was, therefore, entitled to claim exemption in regard to its income from kuries.

The Tribunal, at the instance of the revenue, referred the following two questions for the opinion of the High Court :

"1. Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is correct in law in holding that the income derived by the assessee is exempt under section 11 (1) (a) of the Income-tax Act, 1961 ?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that

setting apart reserves under article 39 of the assessee's memorandum did not vitiate the charitable purpose of the institution ?"

The assessee also filed two writ petitions in the High Court challenging, by one writ petition, a notice for reopening an assessment and by the other, a notice calling upon it to file a return. The High Court answered both the questions in favour of the assessee, allowed the writ petitions and quashed the notices. These appeals by special leave are directed against the judgment and orders of the High Court.

On the first often two questions referred to the High Court for its opinion it becomes necessary to consider comparatively the relevant provisions of section 4 (3) of the Indian Income-tax Act, 1922, as it existed when the Kerala High Court decided the Dharmodayam Co.'s case [1962] 45 ITR 478 (Ker) on December 20, 1961, and the provisions contained in the relevant part of section 11 read with section 2 (15) of the Income-tax Act, 1961. Section 4 (3) of the Act of 1922 read thus :

"4. (3) Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them :

(i) Subject to the provisions of clause (c) of sub-section (1) of section 16, any income derived from property held under trust of other legal obligation wholly for religious or charitable purposes, in so far as such income is applied or accumulated for application to such religious or charitable purposes as relate to anything done within the taxable territories, and in the case of property so held in part only for such purposes, the income applied or finally set apart for application thereto :

Provided that such income shall be included in the total income ...

(b) in the case of income derived from business carried on on behalf of a religious or charitable institution, unless the income is applied wholly for the purposes of the institution and either -

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

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

Section 11 (1) (a) of the Act of 1961 reads thus :

"11. Income from property held for charitable or religious purposes. -

(1) Subject to the provisions of sections 60 to 63, the following income shall not be included in the total income of the previous year of the person in receipt of the income -

(a) income derived from property held under trust wholly for charitable or religious purposes, to the extent to which such income is applied to such purposes in India; and, where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of twenty-five per cent. of the income from such property".

Section 2 (15) of the Act of 1961 says :

"2. In this Act, unless the context otherwise requires, -

(15) 'charitable purpose' includes relief of 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".

It is undeniable that the law governing exemption from taxation of income derived from property held for religious or charitable purposes has undergone significant changes after the enactment of the Act of 1961. Under section 4 (3) (i) of the Act of 1922, in so far as is relevant for the present purposes, income derived from property held under trust for religious or charitable purposes was exempt from taxation in so far as such income was applied for those purposes. Section 11 (1) (a) of the Act of 1961 contains for our purposes, an identical provision, subject of course to the argument of the revenue with which we will presently deal, that the definition of "charitable purposes" in section 2 (15) of that Act alters the very basis of exclusion of income from property held for religious or charitable purposes. By clause (b) of the proviso to section 4 (3) (i) of the Act of 1922, which was in the nature of an exception, income mentioned in clause (i) was includible in the total income of the assessee if it was "derived from business carried on on behalf of a religious or charitable institution". But clause (b) of the proviso contained an exception to an exception to the effect that even income derived from business carried on on behalf of a religious or charitable institution was to be exempt from tax if it was applied wholly for the purposes of the institution and either the business was carried on in the course of the actual carrying out of a primary purpose of the institution, or the work in connection with the business was mainly carried on by the beneficiaries of the institution. Section 2 (15) of the Act of 1961 defines "charitable purpose" to include relief of 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. By reason of this definition, income derived from a business which is carried on for the advancement of an object of general public utility has to be included in the assessee's total income, if it involves carrying on of any activity for profit. Under the Act of 1922, income derived from a business carried on for the purpose of advancing an object of general public utility was excludible from the assessee's total income, even if such advancing involved the carrying on of an activity for profit, if the income was applied wholly for the purposes of the institution and either the business was carried on in the course of the actual carrying out of a primary purpose of the institution or the work in connection with the business was mainly carried on by the beneficiaries of the institution. This is the significant change brought about by the 1961 Act.

But we are unable to accept the submission made by Mr. Ramamurthi on behalf of the revenue that by reason of the change brought about by the Act of 1961 in the definition of the expression "charitable purpose", the judgment of the Kerala High Court in Dharmodayam's case [1962] 45 ITR 478 (Ker) is not good law and that the decision therein cannot any longer govern the question whether income received by the assessee by conducting the kuries is exempt from taxation. The entire argument is built around the words "advancement of any other object of general public utility not involving the carrying on of any activity for profit" which occur in the definition of "charitable purpose" contained in section 2 (15) of the Act of 1961, particular emphasis being laid by counsel on the expression "not involving the carrying on of any activity for profit". This argument assumes that the respondent is running the kuries as a matter of advancement of an object of general public utility. If that were so, it would have been necessary to inquire whether conducting the kuri business involved the carrying on of any activity for profit. The answer, perhaps, to that inquiry might have

been in the affirmative since, speaking generally, the conduct of a business involves the carrying on of an activity for profit. But the assumption that the respondent is running the kuri business as matter of advancement of an object of general public utility or for that purpose is plainly contrary to the finding of the Kerala High Court in Dharmodayam Co. 's case [1962] 45 ITR 478 (Ker), that the kuri "business itself is held under a trust for religious or charitable purposes". It is a necessary implication of this finding that the business activity was not undertaken by the respondent in order to advance any object of general public utility. The decision of the Kerala High Court was challenged by the revenue in an appeal filed in this court, but that appeal was withdrawn by it. The relevant legislative provision has certainly undergone a change, but the nature of the respondent's activity remains what it was when the Kerala High Court gave its judgment in Dharmodayam Co. 's case [1962] 45 ITR 478 (Ker). It will, therefore, be erroneous to say, as contended by Mr. Ramamurthi on behalf of the revenue, that the Kerala judgment has lost its validity. That judgment, in our opinion, concludes the point that the kuri business is not conducted by the respondent in order to advance or for the purpose of advancing any object of general public utility.

Nothing really turns on the respondent's articles of association or on the circumstance that article 39 was amended in 1963 after the High Court gave its judgment on December 30, 1961. Article 39, as it then stood, has been set out at page 480, para. 9, of the High Court's judgment in Dharmodayam Co.'s case [1962] 45 ITR 478 (Ker). The present article 39 reads thus :

"The profits of this company shall not be divided among the members. From the annual net profits from the working of the company, such proportion as the general meeting may deem fit may be set apart towards a reserve fund for other stability of the company and towards a reserve for bad debts and the balance of the profit may in accordance with the objects in the memorandum be spent on charity, education, industry and other purposes of public interest."

It is undisputed that the respondent-company, which was registered on January 21, 1959, under the Cochin Companies Act, has never engaged itself in any industry or in any other activity of public interest. It is notorious that the memoranda and articles of association of companies usually cover a variety of activities, only a few of which are in fact undertaken or intended to be undertaken. That obviates the necessity for applying for amendment of the articles from time to time and helps to rule out a possible challenge on the ground that the company has acted beyond its powers in undertaking a particular form of activity. The only activity in which the respondent is engaged over the years is the conduct of kuries. On this aspect of the matter the High Court rightly observes [Commissioner of Income-tax v. Dharmodayam Co. [1974] 94 ITR 113, 119 (Ker)] :

"There is no case that Dharmodayam Company ever started any industry; there is also no ground for saying that the object of the company was to start an industry for the purpose of making profit".

We may now notice some of the decisions cited at the Bar. In Commissioner of Income-tax v. P. Krishna Warriar [1964] 53 ITR 176 (SC), it was held by this court in a case which arose under section 4 (3) (i) of the Act of 1922 that clause (b) of the proviso to the section which spoke of income derived from "business carried on on behalf of a religious or charitable institution" did not apply to cases in which the business itself was held in trust. Speaking for the court, Subba Rao J. observed that if business is property and is held under trust the case would fall squarely under the substantive part of clause (i) and, in that event, clause (b) of the proviso cannot be attracted since, under that clause of the proviso, the business mentioned therein is not held under trust but is one

carried on on behalf of a religious or charitable institution. The importance of this decision is two-fold. In the first place, it places in a proper light the decision of the Kerala High Court in Dharmodayam Co.'s case [1962] 45 ITR 478 (Ker), by showing that the High Court having held in that case that the kuri business was itself held by the respondent in trust, there was no scope for saying that the business was carried on on behalf of any religious or charitable institution. Therefore, despite the change brought about by the Act of 1961 by framing a new definition of "charitable purpose", a business which was held in trust cannot by mere reason of the amendment become a business started for the purpose of advancing an object of general public utility. The second aspect on which the decision in Krishna Warriar's case [1964] 53 ITR 176 (SC) is important is that the judgment of the Kerala High Court in Dharmodayam Co.'s case [1962] 45 ITR 478 (Ker) was referred to by this court approvingly.

Counsel for the revenue, however, relies on a subsequent judgment of the Kerala High Court in Commissioner of Income-tax v. P. Krishna Warriar [1972] 84 ITR 119 (Ker) in which the impact of section 2 (15) of the Act of 1961 had to be considered. This case arose out of identical facts as the decision of this court in Commissioner of Income-tax v. P. Krishna Warriar [1964] 53 ITR 176 (SC), which we have discussed above. After referring to the judgment of this court in the earlier case, the Kerala High Court took the view that the income in respect of which exemption was claimed was not excludible from the total income of the assessee since the assessee had commenced a business for the purpose of advancing an object of general public utility involving the carrying on of an activity for profit. The main argument advanced before the Kerala High Court was that the true purpose of the business, as gleaned from all the circumstances of the case, was to afford medical relief and not the advancement of an object of general public utility. The High Court rejected that argument and held that the preparation and sale of ayurvedic medicines cannot be said to be an activity in the nature of medical relief. As explained earlier, in the instant case the last clause of section 2 (15) of the Act of 1961, which is described in various judgments as the fourth category falling within the terms of that section, has no application.

The decision of this court in East India Industries (Madras) P. Ltd. v. Commissioner of Income-tax [1967] 65 ITR 611 (SC) arose out of similar facts as the Kerala judgment in Warriar's case [1972] 84 ITR 119 (Ker). It was held by this court that the carrying on of a business of manufacture, sale and distribution of pharmaceutical, medicinal and other preparations was neither charitable nor religious in character and since the trustees could, under the deed, validly spend the entire income of the trust on such non-charitable objects, the assessee was not entitled to claim deduction under section 15B of the Act of 1922 in respect of donation received by the trust.

In Sole Trustee, Loka Shikshana Trust v. Commissioner of Income-tax [1975] 101 ITR 234 (SC), it was held by this court that though a number of objects, including the setting up of educational institutions, were mentioned in the trust deed as the objects of the trust, at the relevant time the trust was occupied only in supplying the Kannada speaking people with an organ or organs of educated public opinion. This, according to the court, was not "education" within the meaning of section 2 (15) of the Act of 1961, which expression was to be understood in the sense of systematic instruction, schooling or training. Learned counsel for the revenue relies strongly on the observation of Khanna J. at page 242 of the report that, as a result of the addition of the words "not involving the carrying on of any activity for profit" at the end of the definition in section 2 (15) of the Act of 1961, even if the purpose of the trust is "advancement of any other object of general public utility", it would not be considered as a charitable purpose unless the purpose does not involve the carrying on of any activity for profit. This has no application in the instant case since the business of kuries was not started by the respondent with the object or for the purpose of advancing an object of

general public utility.

This judgment will be incomplete without a close and careful consideration of the decision of this court in *Indian Chamber of Commerce v. Commissioner of Income-tax* [1975] 101 ITR 796 (SC) on which counsel for the revenue has placed the greatest reliance. That is understandable because the judgment of the High Court which is now under appeal before us and which is reported in [1974] 94 ITR 113 (Ker) was specifically brought to the notice of the court in the case of *Indian Chamber of Commerce* [1975] 101 ITR 796 (SC) and was criticised therein an applying the wrong test. It is urged on behalf of the revenue that as the three-judge Bench having already overruled the judgment in appeal before us, there is nothing left for us to do save to allow this appeal filed by the revenue. Having given our most anxious and respectful consideration to the judgment in the case of *Indian Chamber of Commerce* [1975] 101 ITR 796 (SC) we find ourselves unable to accept this submission. The memorandum and articles of association of the assessee in that case, the *Indian Chamber of Commerce*, indisputably showed that the Chamber was to undertake activities for the purpose of advancing objects of general public utility (page 799). The Chamber received income, amongst other sources, from (a) arbitration fees, (b) fees collected for the certificates of origin, and (c) share in the profit made by issuing certificates of weighment and measurement. The bone of contention was whether this income was excludible under section 11 (1) (a) read with section 2 (15) of the Act of 1961. As said by Krishna Iyer J. (page 799), who spoke for the court, the straight question to be answered was whether the three activities which yielded profits to the Chamber involved the carrying on of any activity for profit. Observing that the various chambers of commerce were established in the country in order to promote the trading interests of the commercial community (page 802), the court held that by the new definition in section 2 (15), the benefit of exclusion from total income was taken away where in accomplishing a charitable purpose the institution engages itself in activities for profit (page 803). In other words :

"Section 2 (15) excludes from exemption the carrying on of activities for profit even if they are linked with the objectives of general public utility, because the statute interdicts, for purposes of tax relief, the advancement of such objects by involvement in the carrying on of activities for profit" (page 805).

After so holding, the court referred to the decision of this court in the case of *Loka Shikshana Trust* [1975] 101 ITR 234 (SC) and observed- See [1975] 101 ITR 796, 807 (SC) :

"Among the Kerala cases which went on the wrong test we wish to mention one *Dharmodayam Co.'s case* [1974] 94 ITR 113 (Ker). The assessee-company was conducting a profitable business of running chit funds and its memorandum of association had as one of its objects 'to do the needful for the promotion of charity, education and industry'. The court found it possible on these facts to grant the benefit of section 2 (15) by a recondite reasoning. If this ratio were to hold good, businessmen have a highroad to tax avoidance. *Dharmodayam Co.'s case* [1974] 94 ITR 113 (Ker) shows how dangerous the consequence can be if the provision were misconstrued".

This is square and scathing comment on the judgment now in appeal before us and the court has expressed its view in unequivocal language. But we cannot accept that the court "overruled", as stated in the headnote of the report (page 797), the judgment of the Kerala High Court and that we must, without considering the facts of the case, allow the appeal straightaway. The facts of the

instant case were not before the court in the case of Indian Chamber of Commerce [1975] 101 ITR 796 (SC) and it is evident from the passage extracted above that the test applied by the Kerala High Court was held to be wrong on the assumption that the case fell under the last clause of section 2 (15) of the Act of 1961, which was the only part of section 2 (15) relevant for deciding the case of Indian Chamber of Commerce [1975] 101 ITR 796 (SC). Considering further that the word "industry" has been italicised in the passage extracted above, it is plain that the court assumed that the assessee was engaged in running an industry. We have endeavoured to point out that, on the facts of the case, it is impossible to hold that the last clause of section 2 (15) has any application and that, in the light of the activities of the respondent spread over the past several years, no importance can be attached to clause 39 of its articles of association which enables it "to do the needful for the promotion of industry". With great deference, therefore, we are unable to read the decision in the case of Indian Chamber of Commerce [1975] 101 ITR 796 (SC) as overruling the judgment which is under appeal before us. The court as not even apprised there that this appeal was pending against the decision of the Kerala High Court.

We are, therefore, of the opinion, strictly limiting ourselves to the facts of the case and for the reasons mentioned above, that the income derived by the assessee from the kuries is exempt from taxation under section 11 (1) (a) of the Act of 1961.

The second question presents no difficulty. The apprehension that in exercise of the power conferred by article 39 of the articles of association, the general meeting may set apart the entire profit or a substantive part of it for reserves is unfounded. If and when the affairs of the respondent take that shape, the department will have ample powers and opportunity to deny the exemption to the respondent. For the time being it is enough to state that the High Court has found that the respondent has spent the income for charitable purposes. The answer to the second question must, therefore, be that the power to set apart reserves under article 39 will not, without more, vitiate the charitable nature of the institution.

Accordingly, we confirm the High Court's judgment and dismiss the appeals. The appellant shall pay the respondent's cost in one set.

Appeal dismissed.

</html