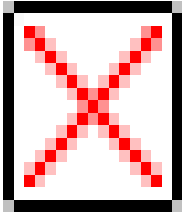


A peep into Tax Exemptions for Instrumentalities of the State

THE POLICY LAB (TPL-09)

SEPTEMBER 12, 2022

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from the proposition that the sovereign does not have to pay taxes to itself, principally the implications in the constitution and sometimes the express or implicit drift in some laws have rendered a general exemption from income tax to the government, whether state or central, and entities recognised as government by law or in terms of court decisions, or those bodies and authorities which exhibit clear traits of a civil authority by way of a mandate for exercise and administration of a public function. Local governments incorporated through a mandate in the constitution empowered with all the powers of a civil authority fall in the category of tax exempt entities. An instrumentality of the state created through statute and discharging public functions, even though bereft of powers of taxation or of a police authority or of eminent domain (right to expropriate private property for public use, for example), if found to be created for exercise of any essential governmental function, too bears no liability to pay taxes on its income.

Sometimes in tax legislations as in Income Tax Act (IT Act) in India, an instrumentality of the state is specifically referred to for its entitlement to tax exemption clearly stipulating the functional vertical of essential governmental function that the said instrumentality of the state is expected to be engaged in. For example, section 10(20) of the IT Act referring to income in the nature of income from house property, capital gains, income from other sources, or from trade or business accruing or arising from supply of a commodity or service (not being water or electricity) within its own jurisdictional area or from supply of water or electricity within or outside its own jurisdictional area in case of a local authority; section 10(23BB) in respect of income of an authority established in a state by or under a state or provincial Act for development of khadi or village industries; section 10(23BBA) in respect of income of any body or authority by or under any central, state or provincial Act providing for administration of public religious or charitable endowments or trusts; section 10(23BBG) in respect of income of Central Electricity Regulatory Commission (CERC) constituted under section 76(1) of Electricity Act, 2003; section 10(23BBH) in respect of income of Prasar Bharti established under section 3(1) of Prasar Bharti(Broadcasting Corporation of India)Act, 1990; section 10(26AAB) in case of an agricultural produce market committee or board constituted under any law; section 10(26B) in respect of income of a corporation set up under a central or state or provincial Act for promotion of interests of members of scheduled castes or scheduled tribes or backward classes; or under section 10(42) in respect of any specified income arising to a notified body or authority established under a treaty or agreement entered into by the central government with 2 or more countries or a convention signed by the central government.

In isolated instances as in section 10(46) of the IT Act, an omnibus exemption is afforded to a general class of cases who have been created under a central or state or provincial Act and have the object of regulating or administering any activity for the benefit of general public. Section 10(46) reads as follows:

"(46) any specified income arising to a body or authority or Board or Trust or Commission (by whatever name called), or a class thereof which-

(a) has been established or constituted by or under a Central, State or Provincial Act, or constituted by the Central Government or a State Government, with the object of regulating or administering any activity for the benefit of the general public;

(b) is not engaged in any commercial activity; and

(c) is notified by the Central Government in the Official Gazette for the purposes of this clause.

Explanation.-For the purposes of this clause, "specified income" means the income, of the nature and to the extent arising to a body or authority or Board or Trust or Commission (by whatever name called), or a class thereof referred to in this clause, which the Central Government may, by notification in the Official Gazette, specify in this behalf;"

When these instrumentalities of the state created by the statute, wholly owned by the state and operating for public purposes are specifically identified and named in the tax statute, their eligibility to exemption is unconditional. Omnibus exemption on the contrary to the class of cases who are established for 'regulating or administering any activity for the benefit of general public' raises definitional and interpretational challenges, foremost being what exact parameters have been set out for screening the qualification claims of the applicants. While no Rules have been framed to examine credentials of an entity to its claims of exemption under section 10(46), one suspects that factors such as nature of activity and whether that activity qualifies as an essential governmental function for general public interest; extent of government control and oversight; treatment of unused income and whether there is a system of flow-back of the unused funds to the political sub-division in the currency of operational life of the entity and complete vesting upon dissolution of the entity, would be determinative of an entity's entitlement to exemption.

Broadly going by these parameters, there would be a class of instrumentalities of the state who undertake purely essential governmental functions of executive nature. Examples could be National Skill Development Corporation (NSDC) mandated to operate schemes under Pradhan Mantri Kaushal Vikas Yojna, National Apprenticeship Promotion Programme and other skill certification courses; or District Mineral Foundation (DMF) trusts created under section 9B of Mines and Minerals Development Regulation (Amendment) Act, 2005 with the object to work for the interest and benefit of persons and areas affected by mining related operations in such manner as may be prescribed by the state government. Or State Aids Control Societies run in accordance with the implementation plan and guidelines of National Aids Control Organisation (NACO). State Legal Services Authorities created under the Legal Services Authorities Act, 1987 designed to provide free and competent legal service to weaker sections of society and see that economic disabilities do not disentitle them from timely access to appropriate justice delivery apparatus should also be falling in that category. So also the State Building and other Construction Workers Welfare Boards created under the force of a central Act- the Building and other Construction Workers (Regulation of Employment and Conditions of Service) Act, 1996. All these bodies duly conferred with tax exemption status under section 10(46) of the IT Act in essence are extensions of executive branch of the government empowered to deal with matters within the scope of executive power delegated to them either through statute or other quasi-legislative routes.

There is another class of instrumentality of the state which discharges both executive and regulatory functions in various combination, where the latter may or may not outweigh the former either in proportionality in extent of implementation or intensity of respective impact. Take for example the State Pollution Control Boards constituted under Water (Prevention and Control of Pollution) Act, 1974 originally for running programme for prevention, control and abatement of water and air pollution, and now additionally entrusted with matters under biomedical waste, municipal solid waste and electronic waste under amended rules of Ministry of Environment, Forest and Climate Change (MOEFCC). Alongside the executive operations such as setting up analytical laboratories and air and water monitoring networks, these boards discharge their regulatory responsibilities through systems of mandatory consent of establishment and consent for operation or through the systems of environmental compensation.

The third variant within the class of state instrumentality undertaking an essential governmental function and apparently fulfilling the conditions applicable to section 10(46) is the regulatory commissions, for example the State Electricity Regulatory Commission constituted under the Electricity Act, 2003 and mandated to determine tariff for generation, transmission and wheeling of electricity, regulate electricity purchase and procurement process of distribution licensees including pricing of electricity, facilitate inter state transmission and wheeling, issue licenses for distribution, transmission and trading, and adjudicate upon disputes inter se among licensees, generating and distribution companies, specify and enforce standards for service delivery and fix trading margins in intra-state trading of electricity. These commissions by nature and mandate do not execute nor expend on any programmatic activity in the manner that we see in other administrative bodies such as labour welfare boards or state computerisation societies or mineral foundation trusts. Earnings are through license fees, license exemption fees and petition filing fees. Expenditure is majorly incurred on establishment and administration.

Similar is the case with State Real Estate Regulatory Authorities constituted under Real Estate (Regulation and Development) Act, 2016 to enforce regulatory oversight in this sector, which includes among others (a) regulate and register real estate projects and real estate agents

(b) fix are-wise standard fees to be levied on allottees or promoters or real estate agents (c) ensure compliance of obligations of the promoters, allottees, and real estate agents (d) conduct investigations (e) impose penalty and interest in cases of contravention of obligations. As is the case with State Electricity Regulatory Commission, receipts of the State Real Estate Authorities are primarily fees from developers and agents, complaint fees from allottees and citizens, penalty and fine, whereas expenditure is on personnel costs and costs on administration. Bereft of any statutory mandate to spend on programmatic activities, surpluses of both kinds of regulatory commissions are rolled into making investments, which keep on increasing from year to year. One state electricity regulatory commission for example had a corpus/ capital fund of Rs 2,050 million (including bank deposits of Rs 1,930 million) and interest on investments in excess of Rs 170 million for the year ended 31-3-19. Same is the story across all such regulatory commissions.

Entities authorised for omnibus exemption under section 10(46) whether purely administrative or purely regulatory or a mix of administrative cum regulatory are creatures of central or state statutes and operate for public purposes or as the legislative formulation goes 'for the benefit of general public'. Instrumentalities of the state engaged in administering any programmatic activity squarely fall in the scope of exemption, whereas those engaged in regulatory aspects may well be tangentially falling within the meaning of 'for the benefit of general public'. Both categories however on account of latitude provided under the law are not bound by the restrictions of section 11(1)(a) relating to mandatory incurring of expenditure of at least 85% of gross income or section 11(5) relating to specified modes of investments or proviso to section 2(15) which circumscribes the definition of 'general public utility'. It is for that reason alone that regulatory bodies discharging an essential governmental function but without any express mandate to invest in any programmatic activity keep on adding the yearly surpluses to their investments and let huge funds lie as deposits in banks. It is appropriate that this matter of a state instrumentality engaged in purely regulatory function in context of wide and consequential latitude afforded to them qua trusts and funds is relooked for allowing exemption under section 10(46), since to many there is no better action 'for the benefit of general public' than paying taxes on your surpluses.