

Master Class

Viabale and Sustainable Operating Structures in School Education





Mr. Praveen Raju

Co-Chair, FICCI ARISE & Founder, Suchitra Academy

- Mr. Praveen is the founder of Suchitra Academy, an international school based in Hyderabad, India.
- Previously, Praveen was the Executive Director of Indus International School, Hyderabad and the Founder Chairman of Indus Early Years, both among the top schools of India in their categories.
- He was also the founder/Vice President of TIE Hyderabad and is the Co-Chairman of FICCI Arise.



Mr. Mithun D'Souza

Partner, LLP, EY

- Mr. Mithun has worked in the practices of Ernst & Young in India and USA for over 16 years.
- His major focus has been on the regulatory aspects of the education sector for over a decade. Has clients in the K-12, higher education, vocational and education services sub-sectors
- He has been primarily involved in the set up, scaling up, collaboration, regulatory interface and acquisitive phase of clients in the education sector, where he has been involved in advisory and implementation of projects.



Mr. Nachiket Deo

Partner, Private Equity, EY

- Mr. Nachiket is a Partner with EY's Transaction Tax Practice. He is a Chartered Accountant and has been with EY since 2004. He specialises in Private Equity transactions.
- Over his 16+ years of transactions experience, he has structured and led several such large and complex cross border transactions.
- He has expertise in buy-side as well as vendor tax due diligence, acquisition and exit structuring, tax modelling, tax negotiations, withholding tax issues, post acquisition integration and cash repatriation structuring as well as regulatory issues associated with PE investments.

FICCI ARISE

Viable and Sustainable Operating Structures in School Education

09 December 2022



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Structuring in the Education sector



Structuring in Education sector

A. The need for Structuring

- ▶ General regulatory requirement for K-12 schools, to be housed in Not-for-profit organizations (Trusts, Societies, Section 8 Cos)
- ▶ FDI / any other investment in NPOs is not permitted; Surplus from NPOs cannot be taken out
- ▶ NPOs imparting education are eligible for income-tax exemptions, subject to conditions
- ▶ However, no restriction exists for NPOs undertaking education to outsource non-core activities to a for-profit entity
- ▶ The need for outsourcing non-core activities is based on the philosophy of focusing efforts on core operations, while de-risking and operating non-core functions in another entity
- ▶ M&A activity involving education institutions, has usually involved a for-profit-entity providing infra / other services to the NPO housing the educational institution

Structuring in Education sector

B. Illustrative considerations

1

CBSE / ICSE /
State law
implications

E.g. minimum
period of lease
of infra is
prescribed;
franchisee fee
payments
restricted in
CBSE

2

Safeguarding
income-tax
exemptions

Preventing exit
tax trigger

3

Reasonability
of related
party
transactions to
be maintained

New penalties
prescribed for
non-
compliance

4

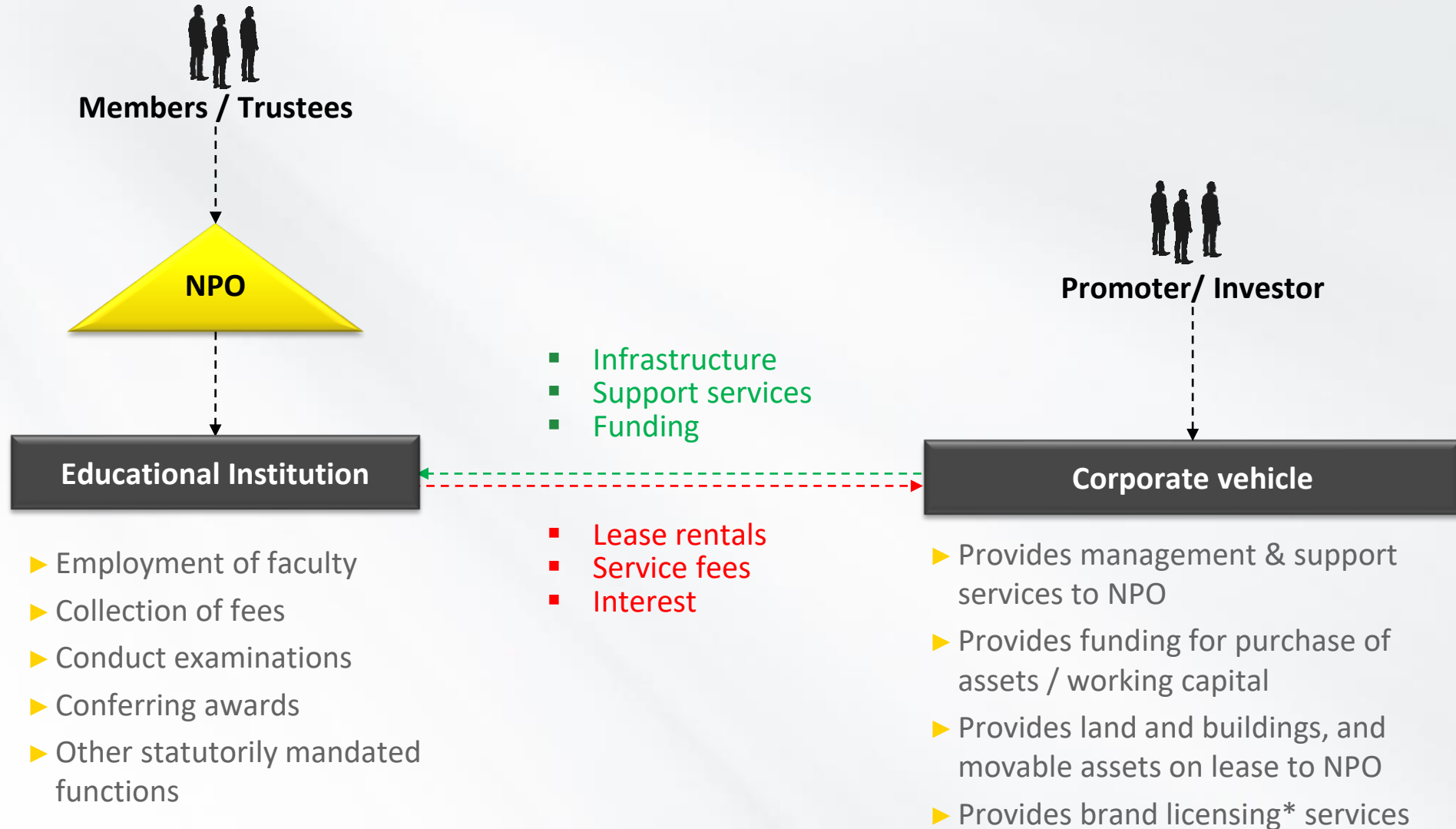
Managing
transaction
costs – Stamp
duties / GST
leakages

5

Other matters:
Compliance
with allied
laws; Charter
document
provisions;

Structuring in Education sector

C. Typical corporatization structure



* May be a challenge from CBSE affiliation standpoint

Structuring in Education sector

D. Key elements of a robust structure

1

Substance - Capability of corporate vehicles to render services to be established. Necessary employees, assets and expenses to be housed in the corporate vehicle. To consider transition plan to a corporate vehicle

2

Documentation - Robust matrix of documentation to be maintained between NPOs and corporate vehicles to substantiate that NPO is engaged in core educational activities and only non-core educational services are outsourced

3

Pricing – Services to be rendered at reasonable price to avoid penalty / taxability of such transactions. Method of ascertaining ‘reasonableness’ to be documented. Courts have usually accepted open bids, internal comparables, market rates. Valuation reports / transfer pricing studies are often used

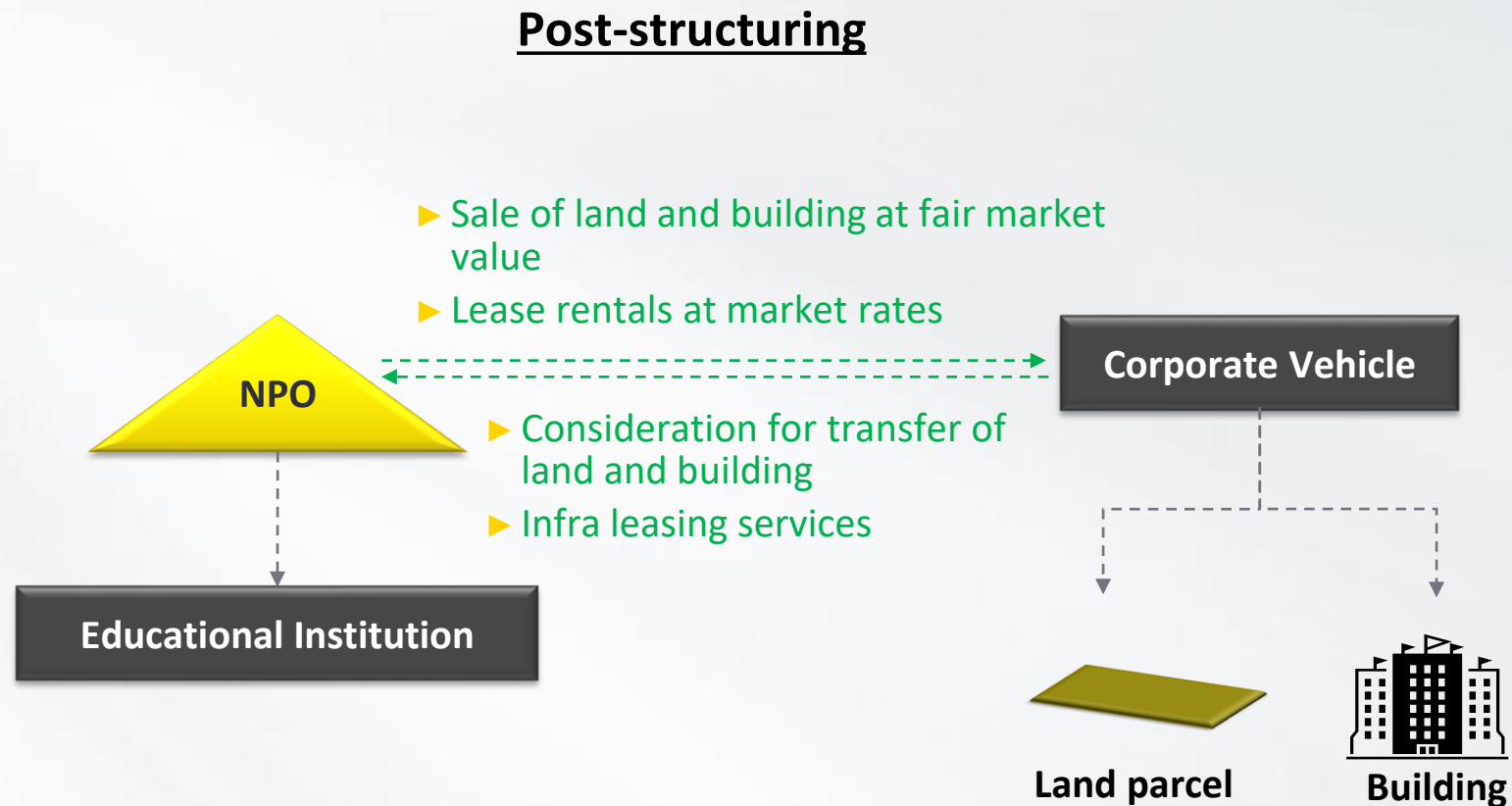
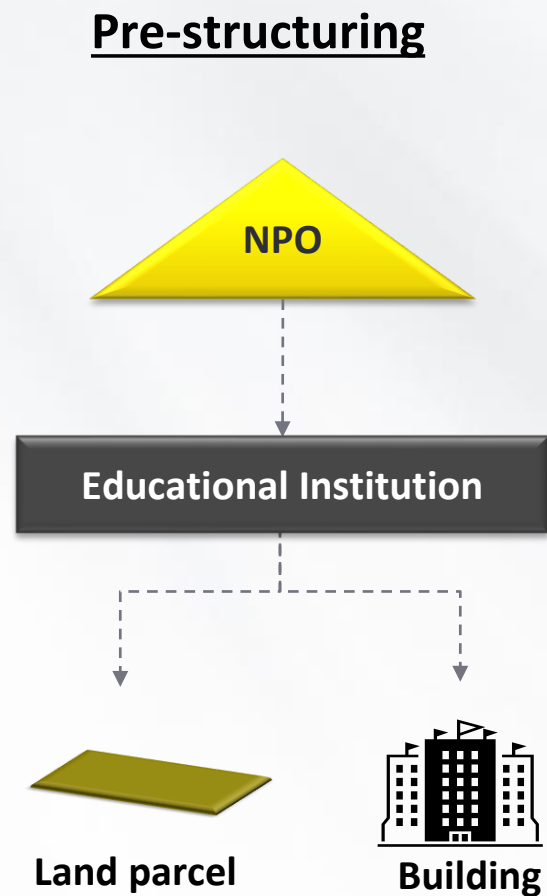
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Structuring thoughts



Structuring thoughts

A. Sale and lease back – Overview



Structuring thoughts

A. Sale and lease back – Key considerations

1

Income-tax considerations – For the NPO

- ☐ Ensure that the consideration payable by the Corporate Vehicle to the NPO is “reasonable” – Advisable to have a report in place from a valuer – Valuation report to consider and document transaction nuances, to determine reasonability
- ☐ Capital gains exposure on sale of real estate – Evaluate requirement to apply the sale consideration, for claiming exemption as ‘application of income’
 - ☐ Purchase of capital assets
 - ☐ Donations made to other charitable institutions [subject to conditions]
 - ☐ Payment of upfront lease deposit
- ☐ Payment of “reasonable” lease rentals to the Corporate Vehicle should be regarded as “application” of income

Structuring thoughts

A. Sale and lease back – Key considerations

2

Income-tax considerations – For the Corporate Vehicle

- ❑ Gift tax provisions under Section 56(2)(x) may trigger only if the transaction value is less than the stamp duty guidance value
- ❑ Commercial rationale to demonstrate genuineness of the overall 'sale and lease back' arrangement to be documented
- ❑ Adequate safeguards to be incorporated in the lease agreement, to avoid the transaction from being regarded as "transfer"
- ❑ Characterisation of lease rental as Income from House Property vs Business Income would be relevant

Structuring thoughts

A. Sale and lease back – Key considerations

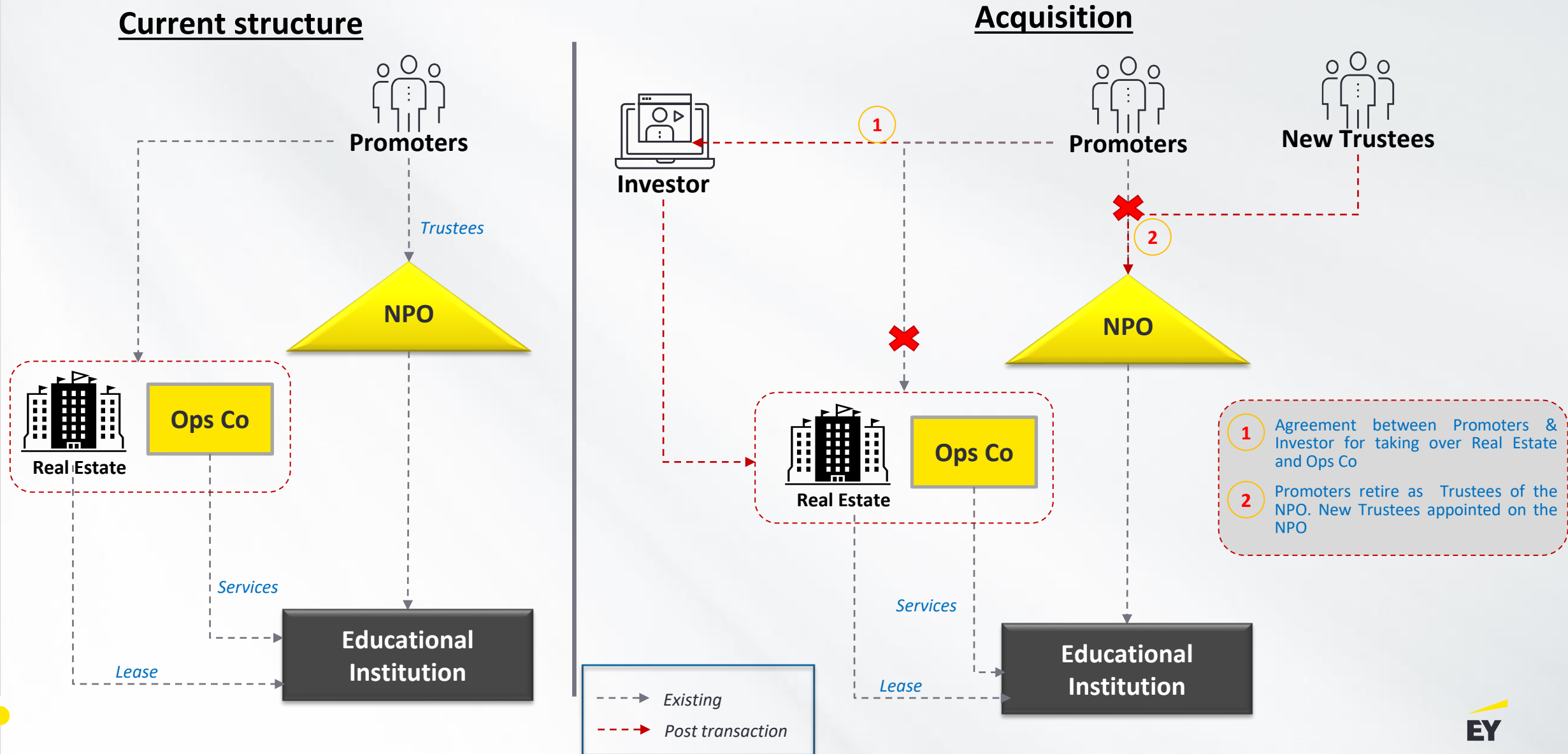
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Other key considerations

- ☐ Sale of real estate should not be subject to any GST exposure
- ☐ However, GST may be applicable on the lease rentals collected by the Corporate Vehicle
 - ☐ The NPO may not be able to avail the input GST credit, since output services are exempt from levy of GST
- ☐ Stamp duty leakage based on jurisdiction

Structuring thoughts

B. Acquisition / Takeover – Overview



Structuring thoughts

B. Acquisition / Takeover – Key tax implications

1

Transfer of shares in Ops Co / Real estate Co

- ❑ Capital gains triggered in promoters hands on transfer of shares. Rate of tax 20% for LTCG (plus surcharge and cess)
 - ❑ Non-residents are subject to a lower tax rate of 10% (plus surcharge and cess). Recently introduced deemed residency rules to be considered
 - ❑ Tax treaty benefits in certain jurisdictions for shares held before March 31, 2017 may be explored
 - ❑ 54F exemption for acquisition of house property available
- ❑ Consider the notional FMV provisions under Section 50CA of ITA
- ❑ Tax deduction / collection obligations to be evaluated for the Buyer / Seller
- ❑ Terms of SPA to be thought through to manage tax / regulatory risks – Practical issues include indemnities for the NPO; Managing net working capital levels at the NPO

Structuring thoughts

B. Acquisition / Takeover – Key tax implications

2

Transfer of Real Estate (if held directly by Promoters)

- ❑ Capital gains implications and tax withholding / tax collection obligations to apply, as discussed in case of transfer of shares
- ❑ Notional consideration provision to apply, having regard to the stamp duty values [Section 50C]

3

Other key considerations

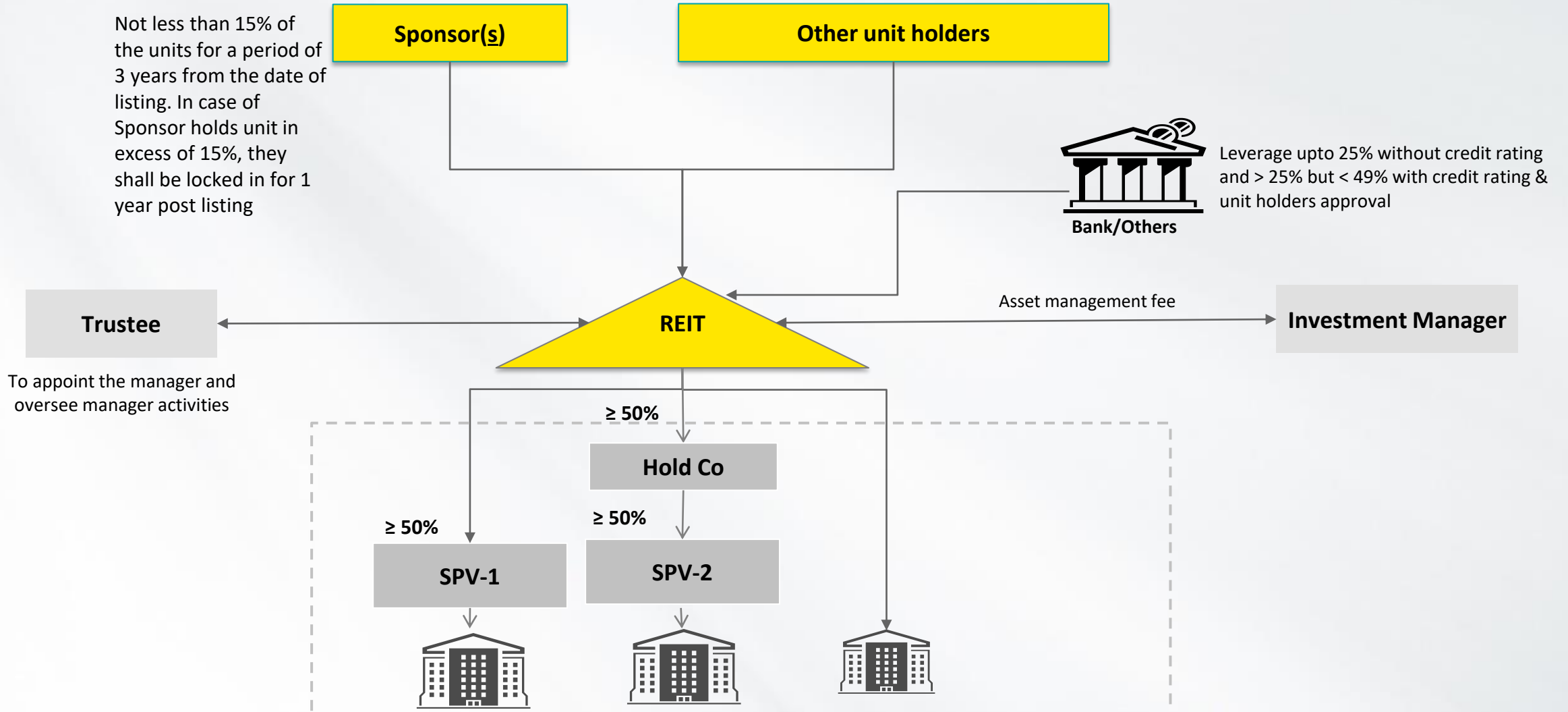
- ❑ Change in Trustees / NPO members to be managed
- ❑ Notifying tax authorities in case of sale of assets from the NPO – Recent IT exemption conditions prescribe this requirement
- ❑ FDI permissibility



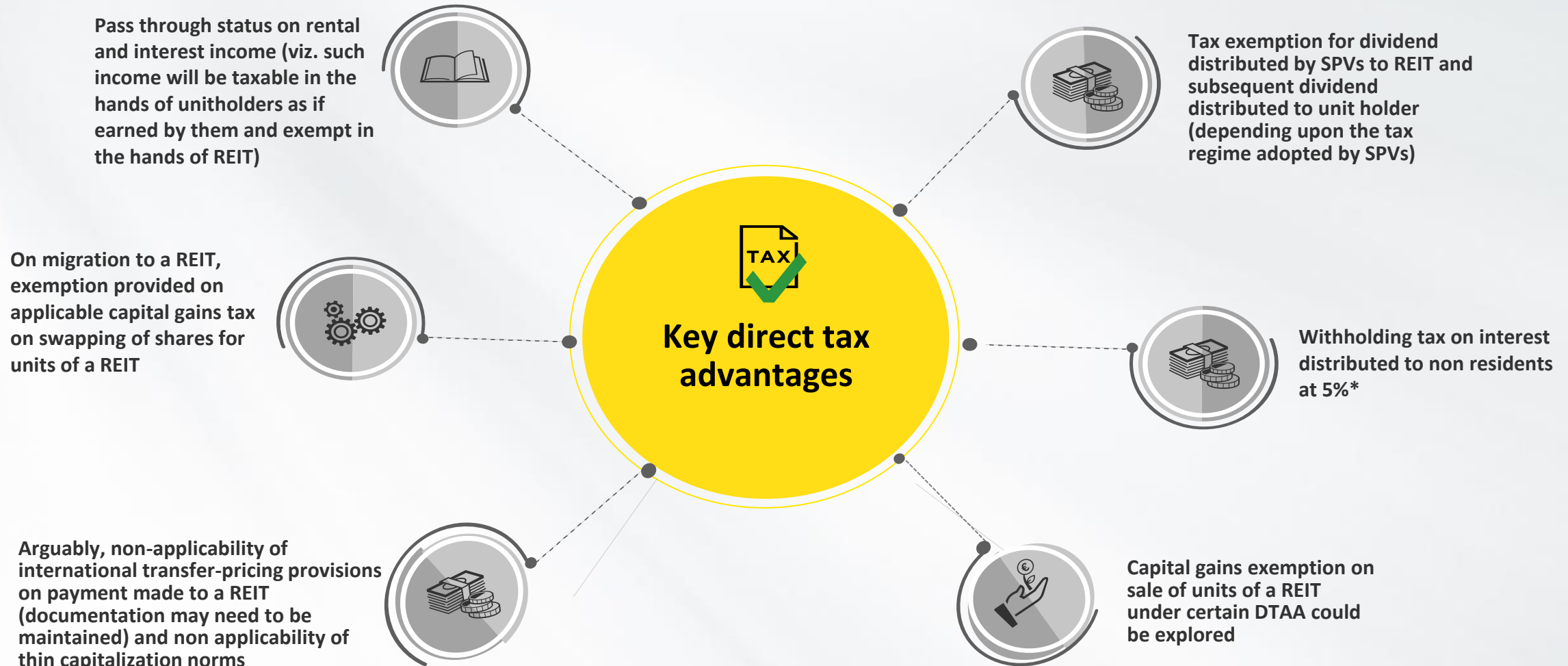
REIT



Typical REIT structure



REIT – High level tax implications



* Plus applicable surcharge & education cess

4

Overview of recent Supreme Court rulings



Overview of recent Supreme Court ruling

New Noble Educational Society vs CIT

Issue before the Supreme Court

Rejection of claim for approval under the Act, primarily on two grounds:

- A) Educational institutions were not existing **solely** for the educational purposes; and
- B) Educational institutions were **not registered under applicable state laws**

Supreme Court's Ruling

SC upheld the tax authority's order rejecting the grant of approval to the Taxpayers and held:

- **Meaning and scope of 'Education'**: SC continued to adopt a narrower meaning of the term 'education', as scholastic structured learning / imparting formal scholastic learning [reference to earlier SC decision in *T.M.A. Pai Foundation*]
- **Institutions existing 'solely' for education**: Educational institutions qualify for exemption *only if **all the objects relate to education***. Institutions which are profit oriented (except where profits are derived from business incidental to education) would not qualify for exemption. However, generating a reasonable surplus may not debar the exemption, where such surplus is generated in the course of providing education, or activities incidental thereto

Overview of recent Supreme Court ruling

New Noble Educational Society vs CIT

Supreme Court's Ruling

- **Scope of business profits incidental to objects:**
 - Business profits earned by the NPOs would not be exempt, unless the business is incidental to attainment of its objectives, and separate books of accounts are maintained
 - SC considered this as an exception to the requirement of educational institution existing solely for education and not for profits
 - Examples have been cited by the SC, viz, sale of textbooks, school bus facilities, hostel facilities, providing summer camps, etc. as activities incidental to education
- **Requirement of registration under other applicable state laws:**
 - State legislation applicable to public charitable institutions provide a regulatory framework on their activities. Such legislation protects the interest of trusts, especially, funds and properties
 - Compliance with the state legislation helps in ascertaining the genuineness of the trust / society
 - Non-compliance with such legislation could result in denial of income-tax exemption approvals

Overview of recent Supreme Court ruling

New Noble Educational Society vs CIT – Key considerations

- 1 In case of 10(23C)(vi) entities – Education needs to be **sole object** of the NPO
- 2 Are there courses which do not fit within the '**mainstream curriculum-based education**' definition
- 3 Non-education revenue streams to be bucketed into a) Business activities incidental to education b) other activities (potential exposure to tax exists)
- 4 Do you need to make only a reasonable surplus for education activities?
- 5 Ensure **compliance with relevant laws / regulations**
- 6 Is the income-tax exemption a bane? Should you consider exiting the exemption

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