$~4, 5, 7, 11 & 12

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA 7/2013 (Assessment Year 2008-09)

DIRECTOR OF INCOME TAX (EXEMPTION) ..... Appellant

Through Mr. N.P. Sahni with Mr. Nitin Gulati & Mr. P. Roychaudhari, Advocates.

versus

INDIAN TRADE PROMOTION ORGANISATION..... Respondent

Through Mr. Ajay Vohra with Ms. Kavita Jha, Mr. Vaibhav Kulkarni and Ms. Bhoomika Chaudhary, Advocates.

\+ ITA 331/2013 (Assessment Year 2006-07)

DIRECTOR OF INCOME TAX (EXEMPTION) ..... Appellant

Through Mr. N.P. Sahni with Mr. Nitin Gulati & Mr. P. Roychaudhari, Advocates.

versus

COUNCIL OF SCIENTIFIC & INDUSTRIAL RESEARCH ..... Respondent

Through Mr. Ajay Vohra with Ms. Kavita Jha, Mr. Vaibhav Kulkarni and Ms. Bhoomika Chaudhary, Advocates.

\+ ITA 268/2013 (Assessment Year 2008-09)

DIRECTOR OF INCOME TAX (EXEMPTION) ..... Appellant

Through Mr. N.P. Sahni with Mr. Nitin Gulati & Mr. P. Roychaudhari, Advocates.

versus

R.L. KHERA CHARITABLE TRUST ..... Respondent

Through Mr. Ajay Vohra with Ms. Kavita Jha, Mr. Vaibhav Kulkarni and Ms. Bhoomika Chaudhary, Advocates.

\+ ITA 336/2013 (Assessment Year 2009-10)

DIRCTOR OF INCOME TAX (EXEMPTION) ..... Appellant

Through Mr. N.P. Sahni with Mr. Nitin Gulati and Mr. P. Roychaoudhari, Advocates.

versus

M/S INTERNATIONAL GOUDIYA VEDANTA TRUST

..... Respondent

Through Ms. Prem Lata Bansal, Sr. Advocate with Mr. Ram Avtar Bansal, Mr. S.K. Khurana and Mr. Sanjay Sharma, Advocates.

\+ ITA 449/2013 (Assessment Year 2007-08)

THE DIRECTOR OF INCOME TAX LAXMI NAGAR DELHI

..... Appellant

Through Mr. N.P. Sahni with Mr. Nitin Gulati & Mr. P. Roychaudhari, Advocates.

versus

TCI FOUNDATION 10 RAM BAGH AZAD MARKET ROHTAK ROAD NEW DELHI ..... Respondent

Through Mr. Ajay Vohra with Ms. Kavita Jha, Mr. Vaibhav Kulkarni and Ms. Bhoomika Chaudhary, Advocates.

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE SANJEEV SACHDEVA

O R D E R

% 27.11.2013

CM No.14785/2013 (delay) in ITA 449/2013

For the reasons stated in the application, the application is allowed and the delay of 94 days in re-filing the appeal is condoned.

ITA 7/2013, 331/2013, 268/2013 & 449/2013

1. A common issue arises for consideration in the aforesaid appeals. Hence, they are being decided by this common order.

2. The issue raised by Revenue in these appeals pertains to interpretation of Section 11(1) clause 'a' of the Income Tax Act, 1961. For the sake of convenience, the said clause is reproduced below:-

> **"Section 11(1) in The Income- Tax Act, 1995**
>
> (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 fifteen per cent of the income from such property."

3. The contention of Revenue is that depreciation allowed on capital assets cannot be treated as application of income under the said clause. In case depreciation was allowed and treated as application of income, then the assessee would be entitled to double deduction as purchase or acquisition of capital assets for consideration was also treated as application of income. It is submitted that purposive interpretation should be given to the said clause as the legislative intent was that a charitable institution must spend 85% of the funds available with them during the financial year itself and they should not carry forward the funds beyond 15%. Accordingly, if an assessee had acquired an asset and price paid was treated as application of income and had also claimed the said amount as expenditure in its income expenditure account, depreciation on the asset should not be allowable as application of income under Section 11(1)(a) of the Act.

4. Revenue relies upon decision of the Kerala High Court in ***Lissie Medical Institution vs. CIT*** (2012) 348 ITR 344 (Ker). The said decision, no doubt, supports the proposition propounded by the Revenue and we would like to reproduce the following observations:-

5. "Senior counsel, Sri A. K. J. Nambiar, appearing for the assessee, submitted that the

assessee has been filing income-tax returns for several years including the assessment year 2005-06, and disallowance is made only for this year. Since business income has to be as stated in section 29 by granting all deductions provided under sections 30 to 43D which includes depreciation under section 32, the assessee is entitled is the case pressed before us by the senior counsel appearing for the assessee. We have no doubt in our mind that business income of charitable trust also has to be computed in the same manner as provided under section 29 of the Income-tax Act. However, the issue that requires consideration is when the expenditure incurred for acquisition of depreciable assets itself is treated as application of income for charitable purposes under section 11(1)(a) of the Act, should not the cost of such assets to be treated as nil for the assessee and in that situation depreciation to be granted turns out to be nil. However, if depreciation provided is claimed on notional cost after the assessee claims 100 per cent. of the cost incurred for it as application of income for charitable purposes, the depreciation so claimed has to be written back as income available. In fact, going by the several decisions of the various High Courts, we are sure that based on these decisions all the charitable institutions will be generating unaccounted income equal to the depreciation amount claimed on an year to year basis which is nothing but black money. This aspect is not seen considered in any of these decisions. We, therefore, sought the views from the Central Board of Direct Taxes. Senior standing counsel, Sri P. K. R.

Menon, appearing for the Revenue, produced clarification obtained from the Central Board wherein they have stated as follows :

"The Central Board of Direct Taxes is of the considered view that where an assessee has acquired an asset through application of income and has also claimed this amount as expenditure in its income expenditure account, depreciation on such asset would not be allowable to the assessee. Such notional statutory deductions like depreciation, if claimed as deduction while computing the income of the 'the property held under trust' under the relevant head of income, is required to be added back while computing the income for the purpose of application in the income expenditure account. This would imply that a correct figure of surplus from the trust property is reflected in the income and expenditure account of the trust to determine the income for the purpose of application under section 11 of the Income-tax Act. This would reduce the possibility of revenue leakage which may be a cause for generation of black money."

6. From the above, what is clear is that the Central Board also confirms the view taken by us that after allowing cost of acquisition as application of income for charitable purposes and over and above if depreciation is claimed on such assets, so much of the depreciation allowed will generate income outside the books of account and unless the depreciation is simultaneously written back by the assessee

as income available for application for charitable purposes in the next year, there will be violation of section 11(1)(a) of the Act. We find that the hon'ble Supreme Court has clearly stated this position, though not in the same context. In the decision in Escorts Ltd. v. Union of India [1993] 199 ITR 43 (SC) relied on by the Tribunal wherein the hon'ble Supreme Court states as follows (page 60) :

"The mere fact that a baseless claim was raised by some over enthusiastic assessees who sought a double allowance or that such claim may perhaps have been accepted by some authorities is not sufficient to attribute any ambiguity or doubt as to the true scope of the provisions as they stood earlier."

For the forgoing reasons, we dispose of the appeal by confirming the order of the Tribunal. However, as rightly pointed out by the counsel for the assessee the system of allowing depreciation was followed by the assessee for several years and it was consistent with the view taken by several High Courts in India in the decisions above cited. We find force in this contention because assessee cannot be taken by surprise by disallowing depreciation which was being allowed for several years and to demand tax for one year after making disallowance. We feel the assessee should be allowed to write back the depreciation for this year and even for previous and then allow the same to be carried forward for application for subsequent years. It is for the assessee to write back depreciation and if

done the Assessing Officer will modify the assessment determining higher income and allow recomputed income with the depreciation written back by the assessee to be carried forward for subsequent years for application for charitable purposes. The appeal is disposed of as above by answering the question in favour of the Revenue but by granting the relief to the assessee as above."

5. As is clear from paragraph 6 above, the Kerala High Court has relied upon the decision of the Supreme Court in the case of ***Escorts Ltd. vs. Union of India,*** (1993) 199 ITR 43 (SC). We shall refer to this judgment subsequently. In order to appreciate the contention raised by the Revenue, we would like to give one example which would clarify the contention or the issue raised before us. An assessee, a charitable institution, say has income from property held under Trust of Rs.1,00,000/-. As per mandate of clause 'a', 85% of the said amount i.e. Rs.85,000/- should be spent in the said financial year. The said assessee spends and acquires a capital asset for Rs.50,000/-. The purchase price for acquisition of the capital asset i.e. Rs.50,000/- is treated as application of income for the purpose of clause 'a' to Section 11(1). On the capital asset, the assessee also claims depreciation say @ 20%. Accordingly, the assessee claims that the application of income would include Rs.10,000/- which is to be allowed as depreciation as to this extent, the asset purchased has depreciated. In other words, Rs.60,000/- is to be treated as application of money for the purpose of clause 'a' to Section

11(1).

6. Initially we were inclined to accept the submission raised by the Revenue that there are several good reasons why we have declined to interfere and refer the matter to a larger bench to consider judgment of this Court in ***DIT vs. Vishwa Jagriti Mission,*** ITA No.140/2012 (Del.).

7. The controversy in question is not new and has been subject matter of judicial opinion and decisions from 1984. In the said year Karnataka High Court in ***Commissioner of Income Tax vs. Society of The Sisters of St. Anne*** 146 ITR 28 (Kar) had after referring to the provisions in question, held:-

> "It is clear from the above provisions that the income derived from property held under trust cannot be the total income because s. 11(1) says that the former shall not be included in the latter, of the person in receipt of the income. The expression " total income " has been defined under s. 2(45) of the Act to mean " the total amount of income referred to in s. 5 computed in the manner laid down in this Act ". The word " income " is defined under s. 2(24) of the Act to include profits and gains, dividends, voluntary payment received by trust, etc. It may be noted that profits and gains are generally used in terms of business or profession as provided u/s. 28. The word " income ", therefore, is a much wider term than the expression ",profits and gains of business or profession ". Net receipt after deducting all the necessary expenditure of the trust (sic).

(13)

There is a broad agreement on this proposition. But still the contention for the Revenue is that the depreciation allowance being a notional income (expenditure ?) cannot be allowed to be debited to the expenditure account of the trust. This contention appears to proceed on the assumption that the expenditure should necessarily involve actual delivery of or parting with the money. It seems to us that it need not necessarily be so. The expenditure should be understood as necessary outgoings. The depreciation is nothing but decrease in value of property through wear, deterioration or obsolescence and allowance is made for this purpose in book keeping, accountancy, etc. In Spicer & Pegler's Book-keeping and Accounts, 17th Edn., pp. 44, 45 & 46, it has been noted as follows :

"Depreciation is the exhaustion of the effective life of a fixed asset owing to ' use ' or obsolescence. It may be computed as that part of the cost of the asset which will not be recovered when the asset is finally put out of use. The object of providing for depreciation is to spread the expenditure, incurred in acquiring the asset, over its effective lifetime; the amount of the provision, made in respect of an accounting period, is intended to represent the proportion of such expenditure, which has expired during that period. "

"At the end of its effective life, the assets ceases to earn revenue, i.e., the capital value has expired and the asset will have to be replaced or a substitute found provision for

depreciation is the setting aside, out of the revenue of an accounting period, the estimated amount by which the capital invested in the asset has expired during that period. It is the provision made for the loss or expense incurred through rising the asset for earning profits, and should, therefore, be charged against those profits as they are earned. "

"If depreciation is not provided for, the books will not contain a true record of revenue or capital. If the asset were hired instead of purchased, the hiring fee would be charged against the profits; having been purchased the asset is, in effect, then hired by capital to revenue, and the true profit cannot be ascertained until a suitable charge for the use of the asset has been made. Moreover, unless provision is made for depreciation, the balance-sheet will not present a true and fair view of the state of affairs ; assets should be shown at a figure which represent that part of their value on acquisition, which has not yet expired. "

In CIT v Indian Jute Mills Association [1982] 134 ITR 68, the Calcutta High Court, while constructing the expression " expenditure incurred " in s. 44A of the Act, observed :

"depreciation claimed shall include the expenditure incurred." There are only two recognised methods of accounting : (1) cash basis, and (ii) mercantile basis. Under the cash basis only cash transactions are recorded. It is only cash receipts and cash

payments which find entries in the books of account. Mercantile system of accounting was explained by the Supreme Court in Keshav Mills Ltd. v. CIT [1953]23 ITR 230 at 230 in the following words :

" The mercantile system of accounting or what is otherwise known as the double entry system is opposed to the cash system of book keeping under which a record is kept of actual cash receipts and actual cash payments, entries being made only when money is actually collected or disbursed. That system brings into credit what is due, immediately it becomes legally due and before it, is actually received and it brings into debit expenditure the amount for which a legal liability has been incurred before it is actually disbursed.

It is not in dispute that if the mercantile system is followed, the depreciation allowance in respect of the trust property should be allowed.

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The depreciation if it is not allowed as a necessary deduction for computing the income from the charitable institutions, then there is no way to preserve the corpus of the trust for deriving the income. The Board also appears to have understood the " income " u/s. 11(1) in its commercial sense. The relevant portion of the Circular No. 5-P (LXX-6) of 1968, dated July 19, 1968, reads:

Where the trust derives income from house

property, interest on securities, capital gains, or other sources, the word 'income' should be understood in its commercial sense, i.e., book income, after adding back any appropriations or applications thereof towards the purpose of the trust or otherwise, and also after adding back any debits made for capital expenditure incurred for the purposes of the trust or otherwise.It should be noted, in this connection, that the amounts so added back will become chargeable to tax u/s. 11(3) to the extent that they represent outgoings for purposes other than those of the trust. The amounts spent or applied for the purposes of the trust from out of the income computed in the aforesaid manner, should be not less than 75 per cent. of the latter, if the trust is to get the full benefit of the exemption u/s. 11(1). "

8. The aforesaid paragraph quotes the Board Circular No.5-P (LXX-6) of 1968 dated 19.07.1968.

9. After the decision of the Kerala High Court in ***Lissie Medical Institution vs. CIT*** (supra), the Board issued a fresh circular or clarification dated 02.02.2012 and has observed:-

"The view of the CBDT to be conveyed to the Court in this regard is as under:-

The Central Board of Direct Taxes is of the considered view that where an assessee has acquired an asset through application of income and has also claimed this amount as expenditure in its income expenditure account, depreciation on such asset would not be alloweable to the assessee. Such notional statutory deductions

like depreciation, if claimed as deduction while computing the income of 'the property held under trust' under the relevant head of income, is required to be added back while computing the income for the purpose of application in the income expenditure account. This would imply that a correct figure of surplus from the trust property is reflected in the Income & Expenditure account of the trust to determine the income for the purpose of application under section 11 of the Income Tax Act. This would reduce the possibility of revenue leakage which may be a cause for generation of black money."

10. We also note that the Kerala High Court, in fact, has noted the clarifications which were earlier issued by the Board in respect of 1968 circular. It is clear from the reasoning given by the Kerala High Court that they have not gone by the express language of Section 11(a) and have purposively interpreted the provision.

11. Clause 'a' of Section 11(1) stipulates that income derived from property held under trust wholly for charitable or religious purposes is to be applied for such purposes in India and where such income is set aside or accumulated, it should not be in excess of 15% of the income from such property. Thus, there is an embargo and probation from accumulating or setting apart income derived from property held under trust beyond 15% of income from such property. If there is a violation of the said provision, proportionate income is deemed to be taxable and not exempt under Section 11(1). The language of the Section is

peculiar and proceeds on its own wording. This aspect has been highlighted and pointed out in the judgment of ***Commissioner of Income Tax vs. Society of The Sisters of St. Anne*** (supra). Decision in the case of ***Escorts Ltd.*** (supra) was considered by the Delhi High Court in ***DIT vs. Vishwa Jagriti Mission*** (supra) decided on 29th March, 2012 and was distinguished for the following reasons.

> "13. The judgment of the Supreme Court in ***Escorts Limited Vs. Union of India (supra)*** has been rightly held to be inapplicable to the present case. There are two reasons as to why the judgment cannot be applied to the present case. Firstly, the Supreme Court was not concerned with the case of a charitable trust/institution involving the question as to whether its income should be computed on commercial principles in order to determine the amount of income available for application to charitable purposes. It was a case where the assessee was carrying on business and the statutory computation provisions of Chapter IV-D of the Act were applicable. In the present case, we are not concerned with the applicability of these provisions. We are concerned only with the concept of commercial income as understood from the accounting point of view. Even under normal commercial accounting principles, there is authority for the proposition that depreciation is a necessary charge in computing the net income. Secondly, the Supreme Court was concerned with the case where the assessee had claimed deduction of the cost of the

asset under Section 35(1) of the Act, which allowed deduction for capital expenditure incurred on scientific research. The question was whether after claiming deduction in respect of the cost of the asset under Section 35(1), can the assessee again claim deduction on account of depreciation in respect of the same asset. The Supreme Court ruled that, under general principles of taxation, double deduction in regard to the same business outgoing is not intended unless clearly expressed. The present case is not one of this type, as rightly distinguished by the CIT(Appeals)."

12. We would like to reproduce Section 35 (2B)(c).

> "Section 35(2B)(a) .....
> (b).....
> (c) Where a deduction allowed for any previous year under this sub-section in respect of expenditure represented wholly or partly by an asset, no deduction shall be allowed in respect of that asset under [clause (ii) of sub-section (1)] of section 32 for the same or any subsequent previous year."

13. The language of the sub-clause 'c' to Section 35(2B) is conspicuous and entirely different and wordings are clear and lucid. The language of Section 11(1), as noticed above, is distinguished and not worded in a similar manner. In ***Escorts Ltd.*** (supra), the Supreme Court was considering the said specific provision and the wordings therein. While dealing with the term "expenditure" and noticing the language it was held that no

duplication or double deduction should be allowed towards depreciation in the same or subsequent year. Thus, the issue was decided against the assessee. Language of Explanation 1 to Section 43(1) can also be referred to and we notice that the language of the said explanation is absolutely different from the language used in Clause (a) to Section 11(1). Section 11(1)(a) is a peculiar provision which postulates application of income and it is not dealing with expenditure as such. The legislative desire is that money should be applied for the purpose of charity. In ***Escorts Ltd.***(supra), the Supreme Court had observed that they were concerned with expenditure and since the entire costs of the capital assets had been allowed and had been set off against the business profit in five years or in one previous year, it was unconceivable that the depreciation should be allowed again on the same asset.

14. From the year 1984 onwards, there have been a number of decisions of various High Courts taking a similar and identical view, as that of ***Society of the Sisters of St. Anne*** (supra). These are as under:-

Income Tax vs. Market Committee, Pipli (2011) 330 ITR 16 (P&H), ***Income Tax vs. Tiny Tots Education Society***, (2011) 330 ITR 21 (P&H), ***Commissioner of Income Tax vs. Manav Mangal Society,*** (2010) 328 ITR 421 (P&H), ***Commissioner of Income Tax vs. Sheth Manilal Ranchhoddas Vishram Bhavan Trust***, (1992) 198 ITR 598 (Guj.), ***Commissioner of Income Tax***

vs. ***Raipur Pallottine Society***, (1989) 180 ITR 579 (M.P.), ***Commissioner of Income Tax vs. Institute of Banking***, (2003) 264 ITR 110 (Bom), and ***CIT vs. Shakuntala Tharal Charitable Foundation***, (2013) 358 ITR 452 (MP).

15. Kerala High Court was also conscious of the said decisions and the fact that Section 11(1)(a) had been interpreted in a different manner. It was in these circumstances that the Kerala High Court in the last portion of paragraph 6, as quoted above, has stated that the assessee would be entitled to write back depreciation and if done, the Assessing Officer would modify the assessment determining the higher income and allow recomputation of depreciation written back for the purpose of application of income for charitable purposes in future or subsequent years. This may lead to its own difficulties and problems as suddenly the entire depreciation written off would have to be added first and then in one year substantial application of income would be required. This may be impractical and would disturb the working of many a charitable institutions. The legal interpretation which has continued since 1984, if disturbed and implemented, would not appropriately resolved. Consistency and certainty is more appropriate.

16. The equally plausible and consistent interpretation of clause (a) of Section 11(1) of the Act is that income derived from property must be calculated as per the principles of the Act. The said clause is not a computation provision and does not disturb the

"income" earned or available but postulates that the "income" as computed in accordance with the provisions of the Act to the extent of 86% must be applied. Application of income may include purchase of a capital asset. The said purchase is valid and taken into consideration for the purpose of ensuring compliance, i.e., application of money or funds and is not a factor which determines and decides the quantum of income derived from property held under trust. Computation of income is separate and distinct and has to be made on commercial basis by applying provisions of the Act.

17. In ITA No. 336/2013 – Director of Income Tax (Exemption) Vs. M/s. International Goudiya Vedanta Trust, Revenue has raised an additional question relating to subscription of Rs.2400/- received from the members. The Tribunal held that the subscription should be treated as a part of the corpus. Keeping in view the small amount involved, we are not inclined to decide this controversy in the present appeal and leave the issue open to be decided in an appropriate case.

18. In view of the aforesaid position, we do not find merit in the present appeals on the said aspect and the same are dismissed.

SANJIV KHANNA, J

SANJEEV SACHDEVA, J

NOVEMBER 27, 2013/st