COMMISSIONER OF INCOME TAX-I, COIMBATORE

v.

M/S. G.R. GOVINDARAJULU & SONS

(Civil Appeal No.4916 of 2006)

SEPTEMBER 03, 2015

[A.K. SIKRI AND R. F. NARIMAN, JJ.]

Income Tax Act, 1961 – s. 11(1)(a) – Deduction from income – Assessment of Charitable Trust – Assessee sought deduction from income, of (1) the amount actually spent for the objects of the Trust, (2) the amount set apart to be spent for charitable purposes and showed his taxable income as 'nil' – Assessing Officer granted deduction of the amount actually spent – However, denied the deduction on the amount set apart by the assessee, on the ground that no option for this purpose was exercised by the assessee before filing of the return – The appellate authority allowed the set apart amount to be deducted – The order in appeal was confirmed by the appellate Tribunal and the High Court – On appeal, held: High Court and the authorities below rightly allowed deduction of set apart amount holding that if option is exercised at the time of filing return, it would be in conformity with the provisions in s. 11 – However, they have gone wrong in treating the entire income as exempted from income tax – The deduction of the set apart amount is permissible only to the extent of 25% of total income – The set apart amount by the assessee, being more than 25%, the entire set apart amount could not have been allowed to be deducted – Appeal allowed – Direction to the Assessing Officer to recompute the taxable income.

Additional Commissioner of Income Tax vs. A.L.N. Rao **1995 (4) Suppl. SCR 348: 1995 (6) SCC 625 – referred to.**

A **Case Law Reference**

1995 (4) Suppl. SCR 348 referred to. Para 3

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From the Judgment and Order dated 07.09.2004 of the High Court of Judicature at Madras, in Tax (Appeal) No. 561 of 2004.

C Jaideep Gupta, Zahaib Hussain, Sadhana Sandhu, Anil Katiyar, B.V. Balaram Das for the Appellant.

V. Prabhakar, Revathy Raghavan, Jyoti Prashar for the Respondents.

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The Judgment of the Court was delivered by

A.K. SIKRI, J . 1. The respondent-assessee is a Public Charitable Trust. It filed its return for the Assessment Year 1994-95 declaring 'nil' taxable income. In the summary of total E income filed by the assessee it had mentioned gross income for the year in the sum of Rs. 99,41,221/- which represented interest receipts, rental income, bus collections, miscellaneous receipts and surplus in GRS hotel. It was further stated that out of this income the assessee had applied and spent a sum of F Rs. 47,27,533/- for the objects of the Trust. In the return it was also stated that it was setting apart a sum of Rs. 32 Lacs to be spent for charitable purposes in the following year. On that basis the assessee claimed that it was entitled to have the G deduction of the entire amount and for the purpose of taxation the income was 'nil' under Section 11 of the Income Tax Act,1961 (hereinafter referred to as 'the Act').

2. Before we proceed further and discuss as to how the H Assessing Officer made the assessment, it would be

necessary to take note of the provisions of Section 11 of the Act which are relevant for our purpose. A

"11. (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— B

[(*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; C

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Explanation.—For the purposes of clauses (*a*) and (*b*),— (*1*) in computing the [fifteen] per cent of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in section 12 shall be deemed to be part of the income; F

(2) if, in the previous year, the income applied to charitable or religious purposes in India falls short of [eighty-five] per cent of the income derived during that year from property held under trust, or, as the case may be, held under trust in part, by any amount— G

(*i*) for the reason that the whole or any part of the income has not been received during that year, or

(*ii*) for any other reason, H

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B (2) [Where [eighty-five] per cent of the income referred to in clause (*a*) or clause (*b*) of sub-section (1) read with the *Explanation* to that sub-section is not applied, or is not deemed to have been applied, to charitable or religious purposes in India during the previous year but is
C accumulated or set apart, either in whole or in part, for application to such purposes in India, such income so accumulated or set apart shall not be included in the total income of the previous year of the person in receipt of the income, provided the following conditions are complied
D with, namely:—]

(*a*) such person specifies, by notice in writing given to the [Assessing] Officer in the prescribed manner, the purpose for which the income is being accumulated or set apart
E and the period for which the income is to be accumulated or set apart, which shall in no case exceed ten years;

[(*b*) the money so accumulated or set apart is invested or deposited in the forms or modes specified in sub-section
F (5)]:]"

This provision has come up for interpretation in *Additional Commissioner of Income Tax vs. A.L.N. Rao [1995 (6) SCC 625]* and the legal position contained therein was explained in
G the following manner:

"A mere look at Section 11(1) (a) as it stood at the relevant time clearly shows that out of total income accruing to a trust in the previous year from property held by i wholly for
H charitable or religious purpose, to the extent the income

is applied for such religious or charitable purpose, the same will get out of the tax net but so far as the income which is not so applied during the previous year is concerned at least 25% of such income or Rs.10,000/- whichever is higher, will be permitted to be accumulated for charitable or religious purpose and will also get exempted from the tax net. Then follows sub-section (2) which seeks to lift the restriction or the ceiling imposed on such exempted accumulated income during the previous year and also brings such further accumulated income out of the tax net if the conditions laid down by sub-section (2) of Section 11 are fulfilled meaning thereby the money so accumulated is set apart to be invested in the Government securities etc. as laid down by clause (b) of sub-section (2) of Section 11 apart from the procedure laid down by clause (a) of Section 11 (2) being followed by the assessee-trust. To highlight this point we may take an illustration. If Rs.1,00,000/- are earned as the total income of he previous year by the trust from property held by it wholly for charitable and religious purposes and if Rs. 20,000/- are actually applied during the previous year by the said trust to such charitable or religious purposes the income of Rs.20,000/- will get exempted from being considered for the purpose of income tax under first part of Section 11(1). So far as the remaining Rs.80,000/- are concerned if they could not be actually applied for such religious or charitable purposes during the previous year then as per Section 11(1) (a) at least 25% of such total income from property or Rs.10,000/- whichever is higher will also earn exemption from being considered as income for the purpose of income tax, that is, Rs.25,000/- will thus get excluded from the tax net. Thus out of the total income of Rs.1,00,000/- which has accrued to the trust Rs.25,000/- will earn exemption from payment of income tax as per

A Section 11(1)(a) second part. Then follows sub-section (2) which states that the ceiling or the limit or the restriction accumulation of income to the extent of 25% of the income or Rs.10,000/-, whichever is higher for earning income tax exemption as engrafted under Section 11(1) (a) will B get lifted if the money so accumulated is invested as laid down by Section 11(2) (b) meaning thereby out of the total accumulated income of Rs.80,000/- accruing during previous year and which could not be spent for charitable or religious purposes by the Trust balance of Rs.55,000/- C if invested as laid down by sub-section (2) of Section 11 will also get excluded from the tax net. But for such investment and if Section 11(1) alone had applied Rs.55,000/- being he balance of accumulated income would have been covered by the tax net. Learned counsel D for the Revenue submitted that the investment as contemplated by sub-section (2) (b) of Section 11 must be investment of all accumulated income in Government securities etc., namely, 100% of the accumulated income E and not only 75% thereof. And if that is not done then only the invested accumulated income to the extent of 75% will get excluded from income tax assessment. But so far the remaining 25% of the accumulated income is concerned it will not earn such exemption. It is difficult to F appreciate this contention. The reason is obvious. Section 11, subsection (1) (a) operates on its own. By its operation two types of income earned by the trust during the previous year from its properties are given exemption from income tax, (i) that part of the income of previous year which is G actually spent for charitable or religious purposes in that year; and (ii) out of the unspent accumulated income of the previous year 25% of such total property income or Rs.10,000/- whichever is higher can be permitted to be accumulated by the Trust, remarked for such charitable or H religious purposes. Such 25% of the income or Rs.10,000/

- whichever is higher will also get exempted from income tax. That exhausts the operation of Section 11(1) (a). Then follows sub-section (2) which naturally deals with the question of investment of the balance of accumulated income which has still not earned exemption under sub-section (1) (a). So far as that balance of accumulated income is concerned, that also can earn exemption from income tax meaning thereby the ceiling or the limit of exemption of accumulated income from tax as imposed by sub-section (1) (a) of Section 11 would get lifted if additional accumulated income beyond 25% or Rs.10,000/- whichever is higher, as the case may be, is invested as laid by Section 11 (2) after following the procedure laid down therein. Therefore, sub-section (2) only will have to operate qua the balance of 75% of the total income of the previous year or income beyond Rs.10,000/- whichever is higher which has not got the benefit of tax exemption under sub-section (1) (a) of Section 11. If learned counsel for the Revenue is right and if 100% of the accumulated income of the previous year is to be invested under sub-section (2) of Section 11 to get exemption from income tax then the ceiling of 25% or Rs.10,000/- whichever is higher, which is available for accumulation of income of the previous year for the Trust to earn exemption from income tax as laid by Section 11 (1) (a) would be rendered redundant and the said exemption provision would become otiose. It has to be kept in view that out of the accumulated income of the previous year an amount of Rs.10,000/- or 25% of the total income from property, whichever is higher, is given exemption from income tax by Section 11(1) (a) itself. That exemption is unfettered and not subject to any conditions. In other words it is an absolute exemption. If subsection (2) is so read as suggested by the learned counsel for the

A Revenue, what is an absolute and unfettered exemption of accumulated income as guaranteed by Section 11(1) (a) would become a restricted exemption as laid down by Section 11(2). Section 11(2) does not operate to whittle down or to cut across the exemption provisions contained B in Section 11(1) (a) so far as such accumulated income of the previous year is concerned. It has also to be appreciated that sub-section (2) of Section 11 does not contain any non obstante clause like " notwithstanding the provisions of sub-section (1)". Consequently it must be C held that Section 11(1) (a) has full play and if still any accumulated income of the previous year is left to be dealt with and to be considered for the purpose of income tax exemption, sub-section (2) of Section 11 can be pressed into service and if it is complied with then such additional D accumulated income beyond 25% or Rs.10,000/-, whichever is higher, can also earn exemption from income tax in compliance which the conditions laid down by sub-section (2) of Section 11. It is true that sub-section (2) of E Section 11 has not clearly mentioned the extent of the accumulated income which is to be invested. But on a conjoint reading of the aforesaid two provisions of Sections 11(1) and 11(2) this is the only result which can follow. It is also to be kept in view that under the earlier Income Tax F Act of 1922 exemption was available to charitable trusts without any restriction upon the accumulated income. There was a change in this respect under the present Act of 1961. Under the present Act, any income accumulated in excess of 25% or Rs.10,000/- whichever is higher, is G taxable under Section 11(1) (a) of the Act, unless the special conditions regarding accumulation as laid down in Section 11(2) are complied with. It is clear, therefore, that if the entire income received by a trust is spent for charitable purposes in India, then it will not be taxable but

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if there is a saving, i.e. to say an accumulated of 25% or Rs.10,000/- whichever is higher, it will not be included in the taxable income. Section 11(2) quoted above further liberalizes and enlarges the exemption. A combined reading of both the provisions quoted above would clearly show that Section 11(2) while enlarging the scope of exemption removes the restriction imposed by Section 11(1) (a) but it does not take away the exemption allowed by Section 11(1)(a). On the express language of Sections 11(1) and (2) as they stood on the Statute Book at the relevant time no other view is possible."

4. To put it in nutshell, the exemption/deduction from the income can be taken in three stages which are as under:

i) The assessee would be entitled to have the deduction of entire amount which has actually been spent and applied for charitable purposes i.e. in furtherance of the objects of the Trust.

ii) The assessee is entitled to set apart 25% of the total income for charitable purposes even if not spent in the year in question and when the option is exercised in this behalf stating that income up to 25% which is set apart would be spent in the succeeding year;

iii) The assessee would be entitled to deduction of the remaining amount, by virtue of sub-section (2), to the extent it is invested in the Government securities as mentioned in sub-section(5).

5. Following the aforesaid principles laid down in Section 11 of the Act, the Assessing Officer found that the assessee had actually spent a sum of Rs.47,27,533/. Deduction to this effect was given by the Assessing Officer and there is no dispute about it.

A 6. Insofar as second issue is concerned, as mentioned above, the assessee set apart a sum of Rs.32 Lacs. This was, however, denied by the Assessing Officer on the ground that no option for this purpose was exercised by the assessee before the filing of the return. Though the assessee had stated B so in the return itself, that was not treated as exercising the option in a valid manner. Admittedly, in the present case, no amount is invested in any Government securities and, therefore, the Assessing Officer held that there was no question of giving any further deduction on the balance income. In this C manner taxable income was assessed.

7. The assessee filed the appeal against the aforesaid order before the Commissioner of Income Tax (Appeals). The submission was that since it has set apart Rs.32 Lacs in terms D of Section 11A Explanation-II, by exercising this option in the return itself that should be treated as valid option. The CIT (Appeals) accepted this contention, which view has been upheld by the Income Tax Appellate Tribunal as well as the High Court.

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8. Insofar as this aspect, viz, exercising the option in the return filed by the assessee is concerned, we are of the opinion that the High Court and the Authorities below are right in their approach. The law does not mention any specific mode of F exercising the option. The said option has to be exercised before filing of the return. According to us, if the option is exercised when the return is filed, that would be treated as in conformity and comply with the provisions contained in Section 11 of the Act.

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9. However, we find that thereafter CIT (Appeals) went wrong. As per the provisions of Section 11(1)(a) of the Act the amount which is actually applied for and spent towards the objects of the Trust is to be allowed. Actual expenditure which

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was made for Rs. 47,27,533/- was allowed by the Assessing Officer also. The aforesaid provision also entitled the assessee to set apart further amount if not spent in the same year and option is exercised in that behalf. However, where CIT (Appeals) has gone wrong is that he ignored the provision which entitled the assessee to exercise such an option only to the extent of 25%. In the instant case, the assessee had exercised the option of setting apart an amount of Rs.32 lacs which was more than 25%. The total income was Rs. 99,41,221/- and 25% thereof would be Rs.24,85,305/-. Thus, the entire amount of Rs. 32 lacs could not have been allowed as directed. This aspect has not been noticed by the High Court as well. No further amount could be allowed as deduction and we do not understand as to how the entire income is treated as exempted from income tax.

10. We, accordingly, allow this appeal by setting aside the order of the High Court and direct the Assessing Officer to recompute the taxable income in accordance with this judgment.

Kalpana K. Tripathy

Appeal allowed.