

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

Date of decision: 2nd July, 2010.

+

ITA No.19/2010

%

DIRECTOR OF INCOME TAX (EXEMPTION)

..... Appellant

Through: Ms. P.L. Bansal with Mr. Paras Chaudhary
& Mr. Anshul Sharma, Advocates.

Versus

M/S BAGRI FOUNDATION

..... Respondent

Through: Mr. Salil Aggarwal with Mr. Prakash
Kumar, Advocates.

CORAM :-

HON'BLE MR. JUSTICE BADAR DURREZ AHMED

HON'BLE MR. JUSTICE RAJIV SAHAI ENDLAW

1. Whether reporters of Local papers may
be allowed to see the judgment? Yes.
2. To be referred to the reporter or not? Yes.
3. Whether the judgment should be reported
in the Digest? Yes.

RAJIV SAHAI ENDLAW, J.

1. This appeal has been preferred against the order dated 27th February, 2009 of the Income Tax Appellate Tribunal (ITAT) dismissing the appeal of the Revenue against the order dated 18th June, 2007 of the Commissioner of Income Tax (Appeals) [CIT(A)] allowing the appeal of the Assessee against the order dated 23rd March, 2006 of the Income Tax Officer (ITO) assessing the income of the Assessee, a Trust duly registered under Section 12AA and duly recognized under Section 80G(5)(vi) of the Income Tax Act, 1961 for the Assessment Year

2003-04 at Rs.31,38,840/- and initiating penalty proceedings against the Assessee for furnishing inaccurate particulars of its income.

2. The Assessee for the relevant year filed return declaring 'Nil' income. The case though processed under Section 143(1) was selected for scrutiny. The Assessee had shown the gross total income for the relevant year as Rs.6,92,453/- and deducted therefrom the amount applied for charitable purposes to the extent of Rs.27,28,001/-. The Assessee had made application of income by donation of Rs.26,66,000/- comprising of donation of Rs.25 lacs to BLB Trust as corpus donation and Rs.1,66,000/- to others. The source of the balance amount over and above the income of Rs.6,92,453/- was from FDR encashment, MIP units and MIP-97 encashment which was the accumulation of income of the past and encashment made out of these accumulations/funds.

3. The ITO found that that donation of Rs.25 lacs as corpus donation to BLB Trust was not from current year's income but out of accumulations from the income of earlier years. The ITO, being of the opinion that owing to the explanation appended to Section 11(2) w.e.f. the Assessment Year 2003-04, any donation made out of income accumulation or set apart during the period of accumulation or thereafter to any trust or institution registered under Section 12AA, as BLB Trust was, was liable to be added in the income of the donor trust, accordingly computed the income as aforesaid of the Assessee.

4. It was *inter alia* the contention of the Assessee before the CIT (A) that the ITO should in any case have given credit of Rs.6,92,453/- being the income of the current year. The CIT (A) found merit in the said contention. It was also the

contention of the Assessee before the CIT (A) that the explanation appended to Section 11(2) was not applicable in the facts of the case because the donation to BLB Trust was not out of the accumulations within the meaning of Section 11(1)(a) but out of the free reserves. The CIT (A) accepted the said contention of the Assessee and held the donation by the Assessee of Rs.26,66,000/- aforesaid including the donation of Rs.25 lacs to BLB Trust to have been made out of excess of income over expenditure and not out of amount accumulated under Section 11(1)(a) of the Act. The appeal was accordingly allowed and the Assessee was held to have not violated the provisions of Section 11(1)(a) or 11(2)(a) of the Act.

5. The ITAT affirmed the order of the CIT (A) and held that the Revenue has not been able to make out any case to controvert or rebut the finding of the CIT(A) of the donation in question having been made by the Assessee out of free reserves and income for the year under consideration and not out of accumulations.

6. The Revenue in the appeal before us *inter alia* raised a question as to whether the “Explanation” appended under Section 11(2) and inserted by the Finance Act, 2002 w.e.f. 1st April, 2003, applies to accumulations mentioned in Section 11(1)(a) of the Act. The following question was framed for adjudication:-

“Whether the explanation after Section 11(2) is applicable in respect of the accumulation upto fifteen percent referred to in Section 11(1)(a) also, as distinct from the accumulation out of eighty-five percent as referred to in Section 11(2) of the Income Tax Act, 1961?”

7. Section 11(1)(a) is as under:-

“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 fifteen per cent of the income from such property.”

Thus the income applied for charitable purposes is not to be included in the total income for the relevant year. A Division Bench of this Court, of which one of us was a member, in *Commissioner of Income-Tax v. Shri Ram Memorial Foundation* (2004) 269 ITR 35 has held that when a donor trust which is itself a charitable and religious trust donates its income to another trust, the provisions of Section 11(1)(a) can be said to have been met by such donor trust and the donor trust can be said to have applied its income for religious and charitable purposes, notwithstanding the fact that the donation is subjected to a condition that the donee trust will treat the donation as towards its corpus and can only utilize the accruing income from the donated corpus for religious and charitable purposes. From the same, it follows that if the Assessee trust either itself uses any part of its income for charitable purposes or donates the same to any other charitable trust, such income is exempt from inclusion in the total income of the Assessee trust for the relevant year. The emphasis is on utilizing the income in the relevant year and accumulation is permitted only to a maximum extent of 15%. As long as such accumulation is not more than 15%, such accumulation is also exempt from inclusion in the total income. However, if more than 15% of the income is

accumulated, under Section 11(1)(a) the same would not be exempt from inclusion in the total income for the relevant year.

8. No conditions are prescribed for the accumulation of up to 15% permitted under Section 11(1)(a). Section 11(2) permits accumulation in excess of 15% also but subject to certain conditions and with which we are not concerned at present. However, the explanation appended w.e.f. 1st April, 2003 to Section 11(2) is as under:-

“Explanation. – Any amount credited or paid, out of income referred to in clause (a) or clause (b) of sub-section (1), read with the Explanation to that sub-section, which is not applied, but is accumulated or set apart, to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.”

9. What follows is that the amount accumulated cannot be donated to another trust. However, the said explanation does not place a total embargo on donations by one trust to another. It does not prohibit the trust from donating its entire income in a relevant year to another trust, as is the law as noticed in the Division Bench judgment in *Shri Ram Memorial Foundation* (supra). The embargo is only on the income of the trust not applied in the relevant year but accumulated or set apart being donated to another trust. The question which arises is whether such prohibition/embargo is only on the accumulations in excess of 15% with which Section 11(2) deals or extends even to accumulation to the extent of 15% under Section 11(1)(a).

10. Ordinarily, the “explanation” having been appended to Section 11(2), is intended to explain 11(2) only and not Section 11(1). There is nothing to indicate that the explanation though placed after sub-Section (2) is intended to explain Section 11(1)(a) also. The Finance Act, 2002 vide which the said explanation was added and/or the objects and reasons thereto do not throw any light as to the reason or purpose of the said explanation or that the same is/was intended to apply even to accumulation to the extent of 15% under Section 11(1)(a).

11. The Supreme Court in *M.P.V. Sundararamier & Co. Vs. State of Andhra Pradesh* AIR 1958 SC 468 and in *Mohanlal Hargovinddas Vs. State of M.P.* AIR 1967 SC 1022 held that the context and setting of the enactment governs the scope of the “explanation”. In *M.K. Salpekar Vs. Sunil Kumar Shamsunder Chaudhari* AIR 1988 SC 1814, the scope of the “explanation” was construed again in the light of the scheme of the enactment. In *M/s. Patel Roadways Ltd. Vs. M/s. Prasad Trading Co.* AIR 1992 SC 1514, the question was whether the explanation to Section 20 of the CPC was to clause (a) only. The Supreme Court decided, taking into consideration the circumstances and the history of the legislation. The Supreme Court in *The Commissioner of Agricultural Income Tax Vs. The Plantation Corporation of Kerala Ltd.* AIR 2000 SC 3714 was concerned with whether the “explanation” at the bottom of Section 5 of the Agricultural Income Tax Act applied to the entire section or to only one of the clauses thereof. It was held that an explanation below a particular clause/sub section is intended to be an explanation to that specific or particular clause/sub section but when at the bottom of the section, is generally meant to explain the entire section.

12. The question whether the conditions prescribed in Section 11(2) with respect to accumulation in excess of 15%, apply also to accumulation to the extent of 15% under Section 11(1)(a) arose for consideration in *Addl. Commissioner of Income Tax v. A.L.N. Rao Charitable Trust* [1995] 216 ITR 697 (SC). The Supreme Court explained the scheme of Section 11 (1)(a) and Section 11(2) as under:-

“ 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 it wholly for 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 it 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.”

13. It was held that the exemption under Section 11(1)(a) (then to the extent of 25% and which was reduced to 15%, also by the Finance Act, 2002) is unfettered and not subject to any conditions and is an absolute exemption. It was further held that if the conditions contained in Section 11(2) are read as applicable to the exemption of up to 15% under Section 11(1)(a) also, then what is an absolute and unfettered exemption of accumulated income guaranteed by Section 11(1)(a) would become a restricted exemption as laid down in Section 11(2). Section 11(2) was held to not operate to whittle down or to cut across the exemption provision

contained in Section 11(1)(a). In this regard, it was further noticed that Section 11(2) does not contain any non obstante clause like “notwithstanding the provisions of the sub-Section (1)”. Consequently, it was held that after Section 11(1)(a) has had full play and still if any accumulated income of the previous year is left to be dealt with and to be considered for the purpose of income exemption, sub-Section (2) of Section 11 can be pressed in service and if it is complied with then such additional accumulated income beyond 15% (then 25%) can also earn exemption from income tax on compliance of the conditions laid down by Section 11(2). Section 11(2) while enlarging the scope of exemption by removing the restriction imposed by Section 11(1)(a) was held not to take away the exemption allowed by Section 11(1)(a).

14. The same view was followed in *S.R.M.C.T.M. Tiruppani Trust v. The Commissioner of Income-Tax* (1998) 230 ITR 636 (SC).

15. The “explanation” appended after Section 11(2) is nothing but an additional condition attached to accumulation in excess of 15% permitted under Section 11(2). We are unable to hold it as a condition on accumulation up to 15% as provided for in Section 11(1)(a) also. We are unable to find any rational classification for imposing the restriction as contained in the “explanation” to the accumulation of up to 15% also when there is no such restriction to donating the entire income of a year to another charitable trust. If the legislature intended to completely ban/discourage *inter se* donation between trusts, it would have changed the position as existing in law as noticed in the Division Bench judgment of this Court in *Shri Ram Memorial Foundation* aforesaid. The legislature did not

do so. Even after the insertion of the “explanation”, if a trust donates its entire income for a year to another charitable trust, it would still be entitled to exemption under Section 11(1)(a). It defies logic as to why such donations cannot be permitted out of 15% accumulation permitted under Section 11(1)(a) itself. There is however rationale for imposing the restriction as contained in the “explanation” (supra) to accumulations in excess of 15%. Such accumulations, but for the conditions imposed in Section 11(2) and in the explanation aforesaid, would have been eligible to be taxed. One of the conditions in Section 11(2)(a) is that the purpose for which accumulation in excess of 15% is being made is to be notified; another condition is of the accumulation being permitted for a period not exceeding 10 years; yet another condition is as to the modes in which the accumulation can be invested. There are no such restrictions on accumulation under Section 11(1)(a). The scheme of the section indicates that the additional condition by way of the aforesaid “explanation” is also intended to apply only to accumulations in excess of 15% under Section 11(2) and not to accumulations upto 15% under Section 11(1)(a). The explanation is not found to be intended to take away something from the accumulation upto 15% permitted without any conditions whatsoever under Section 11(1)(a).

16. The question of law framed is answered accordingly.

17. It also follows that even if the donations by the Assessee herein were to be out of accumulations from previous years’ and not out of surplus reserves, the same would still not be liable to be included in the total income as assessed by the Income Tax Officer and the order of CIT and ITAT would still be upheld. It is

nobody's case that the said accumulations were beyond the accumulation of 15% permitted in Section 11(1)(a).

The appeal is accordingly dismissed.

No order as to costs.

**RAJIV SAHAI ENDLAW
(JUDGE)**

**BADAR DURREZ AHMED
(JUDGE)**

2nd July, 2010

pp