IN THE HIGH COURT OF KERALA AT ERNAKULAM

PRESENT:

THE HONOURABLE MR.JUSTICE C.N.RAMACHANDRAN NAIR

&

THE HON'BLE MR. JUSTICE BABU MATHEW P.JOSEPH

FRIDAY, THE 17TH DAY OF FEBRUARY 2012/28TH MAGHA 1933

ITA.1010/COCH/2008 of I.T.A.TRIBUNAL,COCHIN BENCH,COCHIN DT. 26.10.2010

APPELLANT/RESPONDENT IN ITA:

LISSIE MEDICAL INSTITUTIONS

LISSIE HOSPITAL ROAD

KOCHI 682 018

REPRESENTED BY ITS DIRECTOR

BY ADVS.SRI.E.K.NANDAKUMAR

SRI.A.K.JAYASANKAR

SRI.K.JOHN MATHAI

SRI.P.BENNY THOMAS

SRI.P.GOPINATH MENON

RESPONDENT/APPELLANT IN ITA:

COMMISSIONER OF INCOME TAX,

C.R.BUILDING, I.S.PRESS ROAD,

KOCHI 682 018.

BY ADV. SRI.P.K.R.MENON,SR.COUNSEL, GOI(TAXES)

BY ADV. SRI.JOSE JOSEPH, SC, FOR INCOME TAX

THIS INCOME TAX APPEAL HAVING BEEN FINALLY HEARD ON 17-02-2012, THE

COURT ON THE SAME DAY DELIVERED THE FOLLOWING:

STK

APPENDIX

PETITIONER'S ANNEXURES:

A: TRUE COPY OF THE ASSESSMENT ORDER DATED 31.12.2007.

B: TRUE COPY OF THE ORDER OF THE COMMISSIONER OF INCOME TAX (APPEALS) DATED 29.09.2008.

C: TRUE COPY OF THE ORDER OF THE INCOME TAX APPELLATE TRIBUNAL, DATED 26.10.2010.

D: TRUE COPY OF THE ORDER, UNDER S.254(2) OF THE ACT, OF THE INCOME TAX APPELLATE TRIBUNAL DATED 11.11.2010.

E: A TRUE COPY OF THE ORDER OF THE DEPUTY DIRECTOR OF INCOME TAX(EXCEMPTION),RANGE-4, KOCHI, DATED 01.03.2011.

RESPONDENTS' ANNEXURES: NIL

PA TO JUDGE

STK

[C.R.]

C.N. RAMACHANDRAN NAIR

&

BABU MATHEW P. JOSEPH, JJ.

I.T. Appeal No. 42 OF 2011

Dated this the 17th day of February, 2012

JUDGMENT

Ramachandran Nair, J

The appellant is a charitable institution registered under Section 12A of the Income Tax Act (hereinafter referred to as the Act for short), and is running a hospital. In the course of running the hospital, the appellant acquires medical equipments such as x-ray units, scanning machines etc., which were purchased with the surplus funds available.The entire expenditure incurred for acquisition of capital assets is treated as application of income for charitable purposes under Section 11(1)(a) of the Act. When capital expenditure is treated as application of income for charitable purposes, the appellant virtually enjoys a 100% write off of the cost of assets. However, since medical service is a business activity held in Trust, the appellant claimed all the benefits under the Act including depreciation in the computation of net income. In the course of assessment for the year 2005-06, the Assessing Officer noticed that the appellant has claimed depreciation for Rs.2,16,27,776/-, out of which Rs.18,38,645/- represents depreciation on assets acquired during the relevant previous year and balance towards depreciation on assets held as on the first date of the previous year. According to the Assessing Officer, when he assessee claims expenditure for acquisition of assets as application of income of the charitable trust for charitable purposes, then the assessee is not entitled to claim depreciation in the computation of income. In other words, according to the Assessing Officer, when acquisition of assets is treated as application of income for charitable purposes, the value of assets stands fully written off, and over and above, if depreciation is allowed, the same will result in double deduction of capital expenditure leading to violation of the provisions of Section 11(1) which requires availability of actual income for charitable purposes. Even though the appeal filed against the assessment was allowed by the CIT (Appeals), the Tribunal by following the judgment of the Supreme Court in the case of Escorts Ltd. & Others v. Union of India, reported in 199 ITR 43, allowed the departmental appeal and restored the assessment with the disallowance.

2. After hearing both sides what we notice is that if the assessee treats expenditure on acquisition of assets as application of income for charitable purposes under Section 11(1)(a) and if the assessee claims depreciation on the value of such assets, then in order to reflect the true income to be available for application for charitable purposes, the assessee should write back in the accounts the depreciation amount to form part of the income to be accounted for application for charitable purposes.This is obviously not done by the assessee and so much so, the income which should be available for application for charitable purposes gets reduced by the depreciation amount, which is not permissible under Section 11(1)(a) of the Act. In fact the net effect is that after writing off full value of the capital expenditure on acquisition of assets as application of income for charitable purposes and when the assessee again claims the same amount in the form of depreciation, such notional claim becomes cash surplus available with the assessee, which goes outside the books of accounts of the Trust unless it is written back which is not done. We do not think it is permissible for a charitable institution to generate income outside the books in this fashion.

3. Learned counsel for the assessee has relied on the following decisions of various High Courts in their favour.

(1) Rao Bahadur Calavala's case, reported in 1982 (135) ITR 485 (Mad.)

(2) CIT v. Institute of Banking, reported in 264 ITR 110 (Bom.)

(3) CIT v. Society of Sisters of St.Anne, reported in 146 ITR 28 (Kar)

(4) CIT v. Raipur Pallotine Society, reported in 180 ITR 579 (MP)

(5) CIT v. Sheth Ranchoddas Trust, reported in 198 ITR 598 (Guj.)

(6) CIT v. Manav Mangal Society, reported in 2010 (328) ITR 421 (P & H); SLP filed by department against this decision dismissed by the Supreme Court in 2010 (328) ITR (St.) 9.

(7) CIT v. Market Committee Pipli, reported in 2011 (330) ITR 16 (P & H)

(8) CIT v. Tiny Tot Educational Society, reported in 2011 (330) ITR 21 (P&H).

4. We do not find in any of these decisions this aspect is considered and discussed by any of the High Courts. Learned Senior counsel though referred Circular No.5P (LLX-6) dated 19/06/1968, which is with regard to computation of income of charitable trusts, strangely depreciation is not specifically dealt with in the circular. No decision is seen rendered by the Supreme Court on merits on this issue, even though one of the SLPs filed by the Department against one of the above decisions was dismissed by the Supreme Court. No amendment is seen made to the statute requiring the Trust claiming depreciation to write back the depreciation as income of previous year, if payment for acquisition of assets is treated as application of income for charitable purposes.

5. It is settled position through several decisions of High Courts and Supreme Courts that when business is held in trust by charitable institutions income from business has to be computed by granting deductions provided u/s 30 to 43D as provided under S.29 of the Income Tax Act.

6.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 2005-2006, and disallowance is made only for this year. Since business income has to be as stated in S.29 by granting all deductions provided u/s 30 to 43D which includes depreciation u/s 32, 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 u/s 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 u/s 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% 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 Satutory 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 & 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.

7. From the above what is clear is that 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 S.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 relied on by the Tribunal wherein the Hon'ble Supreme Court states as follows.

"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."

8. 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 dis-allowance.

We feel 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 Revenue but by granting the relief to the assessee as above.

Sd/-

C.N. RAMACHANDRAN NAIR, JUDGE.

Sd/-

BABU MATHEW P. JOSEPH,JUDGE.

ul/-

[True copy]

P.S. to Judge.