Charitable / religious trusts :
Depreciation is allowable as a deduction in computation of income

[333 ITR (Jour) page 33 (Part-4)]

By S.K. Tyagi

The Assessing Officers (AOs) dealing with the cases of charitable / religious trusts, are often not inclined to allow deduction of depreciation allowance on the assets of the trusts, as they are of the view that such a deduction leads to double benefit / deduction.

In this regard it may be stated that in the case of a charitable / religious trusts, even capital expenditure is considered as application of income towards the objects of the trust. Therefore, it is the view of the Assessing Officers that if depreciation is allowed on the assets of such a trust, then the same will lead to double deduction; first by way of deduction of capital expenditure and thereafter, by way of deduction of depreciation on the assets of the trust.

The aforesaid view of the Assessing Officers is, however, not correct, keeping in view the scheme of taxation in respect of charitable / religious trusts. In support of this view, reliance may be placed on the following submissions :

1. The scheme of taxation of charitable / religious trusts is quite different from the taxation of other taxable entities.

In the present context, it has to be clearly understood that the scheme of taxation of charitable / religious trusts is quite different from the taxation of other taxable entities under the Income-Tax Act, 1961 (the Act).

In this regard, it will be appropriate to refer to the provisions of section 11(1) of the Act. For the sake of ready reference the relevant part of section 11(1) is reproduced as follows :

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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;

(b) income derived from property held under trust in par only for such purposes, the trust having been created before the commencement of this Act, to the extent to which such

income is applied to such purposes in India; and, where any such income is finally set apart for application to such purposes in India, to the extent to which the income so set apart is not in excess of fifteen per cent of the income from such property;

(c) income derived from property held under trust—

(i) created on or after the 1st day of April, 1952, for a charitable purpose which tends to promote international welfare in which India is interested, to the extent to which such income is applied to such purposes outside India, and

(ii) for charitable or religious purposes, created before the 1st day of April, 1952, to the extent to which such income is applied to such purposes outside India:

***Provided** that the Board, by general or special order, has directed in either case that it shall not be included in the total income of the person in receipt of such income;*

(d) income in the form of voluntary contributions made with a specific direction that they shall form part of the corpus of the trust or institution.

From the aforesaid provisions of section 11(1)(a) of the Act, it may be seen that income derived from property held under a trust, wholly for charitable and religious purposes will be exempt to the extent to which such income is applied towards the objects of the trust in India and where such income is accumulated or set apart for application towards such objects in India, then the same will also be exempt to the extent to which the income is so accumulated or set apart, provided the same is not in excess of fifteen per cent of the income from such property. Besides, in this connection the provisions of section 11(2), as well as section 11(3) of the Act are also relevant.

From the aforesaid provisions of section 11(1)(a) of the Act, it is quite clear that the scheme of taxation of charitable / religious trusts is quite different from the taxation of other taxable entities under the Act. The reason for the same is that for exemption under section 11(1)(a), the application of income and / or accumulation of such income for the purposes of the objects of the trust, is relevant.

Thus, the concept of "*total income*", as contemplated under section 2(45) of the Act, is not relevant in the present context.

2. The concept of "*total income*", is not applicable in case of charitable / religious trusts

From the provisions of section 11(1)(a) of the Act, it may be seen that the term used therein is "*income*" and not "*total income*", which is applicable for the purposes of taxation of other taxable entities under the Act.

In this context, Circular No.5-P(LXX-6) of 1968, dt. 19.6.1968, issued by the Central Board of Direct Taxes (CBDT), is quite relevant. For the sake of ready reference, the same is reproduced as follows :

Circular No.5-P(LXX-6) of 1968, dated 19.6.1968

1. *In Board's Circular No. 2-P(LXX-5), dated 15.5.1963, it was explained that a religious or charitable trust, claiming exemption under section 11(1), must spend at least 75 per cent of its total income for religious or charitable purposes. In other words, it was not permitted to accumulate more than 25 per cent of its total income. The question has been reconsidered by the Board and the correct legal position is explained below.*
2. *Section 11(1) provides that subject to the provisions of sections 60 to 63, "the following income shall not be included in the total income of the previous year……". The reference in clause (a) is invariably to "income" and not to "total income". The expression "total income" has been specifically defined in section 2(45) as "the total amount of income computed in the manner laid down in this Act". It would, accordingly, be incorrect to assign to the word "income", used in section 11(1)(a), the same meaning as has been specifically assigned to the expression "total income" vide section 2(45).*
3. *In the case of a business undertaking, held under trust, its "income" will be the income as shown in the accounts of the undertaking. Under section 11(4), any income of the business undertaking determined by the ITO, in accordance with the provisions of the Act, which is in excess of the income as shown in its accounts, is to be deemed to have been applied to purposes other than charitable or religious, and hence it will be charged to tax under sub-section (3). As only the income disclosed in the account will be eligible for exemption under section 11(1), the permitted accumulation of 25 per cent will also be calculated with reference to this income.*
4. *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 under section 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 under section 11(1).*

5. *To sum up the business income of the trust, as disclosed by the accounts **plus** its other income computed as above, will be the "income" of the trust for the purposes of section 11(1). Further, the trust must spend at least 75 per cent of this income and not accumulate more than 25 per cent thereof. The excess accumulation, if any, will become taxable under section 11(1).*

From para (2) of the aforesaid Circular, it may be seen that it would be incorrect to assign to the word "*income*", used in section 11(1)(a), the same meaning as has been specifically assigned to the expression "*total income*", vide section 2(45) of the Act.

Further, in para (4) of the aforesaid Circular, it has been laid down that in case of a charitable / religious trust, the word "*income*" should be understood in its **commercial sense**, i.e., book income. Thereafter, in para (5) of the aforesaid Circular, it has been laid down that for the purposes of section 11(1), the "*income*" of the trust will be the business income of the trust, as disclosed in the accounts **plus** its other income from house property, interest, capital gains or other sources, etc.

In the light of the aforesaid Circular of the CBDT, the income of a charitable / religious trust has to be understood in its **commercial sense** and the concept of "*commercial income*" necessarily envisages deduction of depreciation on the assets of the trust.

3. A deduction by way of depreciation in case of a charitable / religious trust is necessary in order to preserve the corpus of a trust

In the present context, it has to be clearly understood that if depreciation is not allowed as a necessary deduction in computing the income of a charitable / religious trust, then there would be no way to preserve the corpus of the trust. Therefore, a charitable / religious trust is entitled to depreciation in respect of the assets owned by it.

In support of this view, reliance may be placed on the following legal precedents :

(i) *CIT Vs Raipur Pallottine Society [1989] 180 ITR 579 (MP)*

It was held in this case that a charitable trust is entitled to depreciation in respect of asset owned by it. In this regard, the relevant part of the Head Note on pages 579 and 580 is reproduced 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 and the amount of provision made in respect of an accounting period is intended to represent the proportion of such expenditure which has expired during that period. If depreciation is not allowed as a necessary deduction in computing the income of a charitable trust, then there would be no way to preserve the corpus of the trust. A charitable trust is, therefore, entitled to depreciation in respect of the assets owned by it.

(ii) *CIT Vs Society of the Sisters of St. Anne [1984] 146 ITR 28 (Karn)*

It was held in this case that depreciation on the assets of the trust is a necessary deduction in order to arrive at the income available for application to charitable and religious purposes. The relevant part of the Head Note, on page 28 of the Report, is reproduced as follows :

If depreciation is not allowed as a necessary deduction for computing the income of a charitable institution, then there can be no way to preserve the corpus of the trust for deriving the income. Therefore, the amount of depreciation debited to the accounts of a charitable institution is to be deducted to arrive at the income available for application to charitable and religious purposes.

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4. The deduction of depreciation in case of a charitable / religious trust is also supported by a number of other legal precedents.

The deduction of depreciation in the case of a charitable / religious trust is also supported by a number of other legal precedents. The same are as follows :

(i) CIT Vs Market Committee, Pipli [2011] 330 ITR 16 (P&H)

In this case, the assessee was registered under section 12AA of the Income-tax Act, 1961, as a charitable trust. The Assessing Officer disallowed the depreciation on the ground that since the income of the assessee was exempt from tax under sections 11 to 13, allowing depreciation to ascertain whether 85 per cent of funds were applied for purposes of trust, would amount to conferring double benefit. This view was affirmed by the Commissioner (Appeals). The appeal of the assessee to the Tribunal was allowed on a statement that the matter was covered in favour of the assessee by another order of the Tribunal.

On further appeal by the Revenue before the High Court, dismissing the appeal, it was held that the income of the assessee being exempt, the assessee was only claiming that

depreciation should be reduced from the income for determining the percentage of funds which had to be applied for the purposes of the trust. There was no double deduction claimed by the assessee. It could not be held that double benefit was given in allowing the claim for depreciation for computing income for purposes of section 11.

(ii) *CIT Vs Institute of Banking [2003] 264 ITR 110 (Bom)*

In this case, the assessee claimed depreciation which was rejected by the Assessing Officer (AO) on the ground that capital expenditure incurred, during the accounting year, was allowed as a deduction from the income of the assessee. The assessee filed an appeal before the CIT(A) who allowed the appeal of the assessee. On further appeal before the Tribunal, by the Department, the Tribunal confirmed the order of the CIT(A).

On appeal against the decision of the Tribunal, it was held by the Hon. High Court that the Tribunal was right in law in directing the AO to allow depreciation on the assets, the cost of which had been fully allowed as application of income under section 11 in the past years.

In this connection, the relevant part of the Head Note on pages 110 and 111 is reproduced as follows :

Normal depreciation can be considered as a legitimate deduction in computing the real income of the assessee on general principles or under section 11(1)(a) of the Income-Tax Act, 1961. Income of a charitable trust derived from building plant and machinery and furniture is liable to be computed in a normal commercial manner although the trust may not be carrying on any business and the assets in respect whereof depreciation is claimed may not be business assets. In all such cases, section 32 of the Act providing for depreciation, for computation of income derived from business or profession is not applicable. However, the income of the trust is required to be computed under section 11on commercial principles after providing for allowance for normal depreciation and deduction thereof from the gross income of the trust.

Income derived from the trust property has also got to be computed on commercial principles and if commercial principles are applied then adjustment of expenses incurred by the trust for charitable and religious purposes in the earlier years against the income earned by the trust in the subsequent year will have to be regarded as application of income of the trust for charitable and religious purposes in the subsequent year in which adjustment had been

made having regard to the benevolent provisions contained in section 11 of the Act and such adjustment will have to be excluded from the income of the trust under section 11(1)(a).

(iii) *DIT (E) Vs Framjee Cawasjee Institute [1993] 109 CTR 463 (Bom)*

It was held in this case that depreciation on depreciable assets had to be taken into account in computing income of the trust, although the amount spent on acquiring such assets had been treated as application of income of the trust in the year in which assets were acquired.

(iv) *CIT Vs Sheth Manilal Ranchhoddas Vishram Bhavan Trust [1992] 198 ITR 598 (Guj)*

It was held in this case that the income from the properties held under trust has to be arrived at in the normal commercial manner without classification under the various heads set out in section 14 of the Income-Tax Act, 1961. The expression "*income*" has to be understood in the popular or general sense and not in the sense in which the income is arrived at for the purpose of assessment to tax by application of some artificial provisions either giving or denying deduction. The computation under the different categories or heads arises only for the purposes of ascertaining the total income for the purposes of charge. Those provisions cannot be introduced to find out what the income derived from the property held under trust to be excluded from the total income is, for the purpose of the exemptions under Chapter III. The amount of depreciation debited to the accounts of the charitable institution has to be deducted to arrive at the income available for application to charitable and religious purposes.

(v) *CIT Vs Tiny Tots Education Society [2011] 330 ITR 21 (P&H)*

In this case the assessee was a charitable institution registered under section 12AA of the Income-tax Act, 1961. In its accounts, the assessee calculated depreciation for the purpose of showing the amount utilized. The Assessing Officer disallowed the depreciation on the ground that the income of the assessee being exempt, claim for depreciation would amount to taking of double benefit. The Commissioner (Appeals) held that deduction for computing income to preserve the corpus of the trust was permissible and did not amount to double benefit. This view was upheld by the Tribunal observing that application of income was not computation of income of the charitable institution. Therefore, the question whether depreciation was to be allowed or not, had nothing to do with the application of income. The income was always to be computed on commercial principles and as per the system of accounting followed by the assessee, subject always to the statutory provisions.

On further appeal by the Revenue before the High Court, dismissing the appeal, it was held that the assessee was not claiming double deduction on account of depreciation. The income of the assessee being exempt, the assessee was only claiming that depreciation should be reduced from the income for determining the percentage of funds which had to be applied for the purposes of the trust. It could not be held that double benefit was given in allowing the claim for depreciation for computing income for purposes of section 11.

(vi) *CIT Vs Rao Bahadur Calavala Cunnan Chetty Charities [1982] 135 ITR 485 (Mad)*

It was, *inter-alia* held in this case that the income from the properties of the trust would have to be arrived at in a normal commercial manner without classification under various heads set out in section 14 of the Act.

It was also held in this case that the expression "*Income*" has to be understood in the popular or general sense and not in the sense in which the income is arrived at for the purpose of assessment to tax by application of some artificial provisions either giving or denying deduction. It was further observed that the computation under the different categories or heads, arises only for the purposes of ascertaining the total income for the purposes of charge. Thus, provisions can not be introduced to find out that the income derived from the property held under the trust to be excluded from the total income is, for the purpose of exemptions under Chapter III.

5. The deduction of depreciation in case of a charitable / religious trust, does not amount to a double benefit / deduction

In this regard, it has also to be understood that the deduction of depreciation in case of a charitable / religious trust is permissible in order to preserve the corpus of the trust and therefore, it does not amount to double benefit or double deduction.

In this connection, it may be stated that in the case of *CIT Vs Market Committee, Pipli [2011] 330 ITR 16 (P&H),* it has been clearly held that deduction of depreciation in case of a charitable / religious trust does not amount to double deduction. Similarly in the case of *CIT Vs Tiny Tots Education Society [2011] 330 ITR 21 (P&H)*, it has been held that the deduction of depreciation in case of a charitable / religious trust, does not amount to double benefit.

Same is the view held by the Bombay High Court in the following cases :

(i) *CIT Vs Institute of Banking [2003] 264 ITR 110 (Bom)*

(ii) *DIT (E) Vs Framjee Cawasjee Institute [1993] 109 CTR 463 (Bom)*

In his regard, at times the Revenue relies upon the judgement of the Apex Court in the case of *Escorts Ltd. Vs Union of India [1993] 199 ITR 43 (SC).* In this case, the assessee had claimed two deductions under sections 32(1)(ii) and 35(1)(iv) of the Act.

The assessee herein had incurred expenditure of a capital nature on scientific research relating to the business which resulted into acquisition of an asset. The assessee had also sought to claim a specified percentage of a written down value of the asset as depreciation.

It was, *inter alia*, held by the Apex Court that it is impossible to conceive of the Legislature having envisaged a double deduction in respect of the same expenditure, one by way of depreciation under section 32(1)(ii) and other by way of allowance under section 35(1)(iv) of the Act. It was further held that in the absence of a clear statutory indication to the contrary, the statute should not be read so as to permit an assessee, two deductions.

The aforesaid judgement of the Apex Court was, however, distinguished by the Punjab and Haryana High Court in the case of *CIT Vs Market Committee, Pipli [2011] 330 ITR 16 (P&H) (SUPRA).* In this context, the observations of the Hon. High Court, on pages 20 and 21 of the Report, are relevant and the same are reproduced as follows :

In the present case, the assessee is not claiming double deduction on account of depreciation as has been suggested by learned counsel for the Revenue. The income of the assessee being exempt, the assessee is only claiming that depreciation should be reduced from the income for determining the percentage of funds which have to be applied for the purposes of the trust. There is no double deduction claimed by the assessee as canvassed by the Revenue. The judgement of the hon'ble Supreme Court in Escorts Ltd. case [1993] 199 ITR 43 is distinguished for the above reasons. It cannot be held that double benefit is given in allowing claim for depreciation for computing income for purposes of section 11. The questions proposed have, thus, to be answered against the Revenue and in favour of the assessee.

From the aforesaid discussion, it is clearly established that the deduction of depreciation allowance in case of a charitable / religious trust, does not amount to double benefit or double deduction.

6. Conclusion

In the light of the discussion in the preceding paragraphs (1) to (5), it is clearly established that :

(i) The scheme of taxation of charitable / religious trusts is quite different from the taxation of other taxable entities.

(ii) The concept of "*total income*", is not applicable in case of a charitable / religious trusts.

(iii) A deduction by way of depreciation in case of a charitable / religious trust is necessary in order to preserve the corpus of a trust.

(iv) The deduction of depreciation in case of a charitable / religious trust is also supported by a number of legal precedents.

(v) The deduction of depreciation in case of a charitable / religious trust, does not amount to a double benefit / deduction.

In view of the aforesaid reasons, it is clearly established that a charitable / religious trust is entitled to deduction of depreciation allowance and such a deduction does not amount to double benefit or double deduction.

S.K.TYAGI
M.Sc., L.L.B., **Advocate**
Ex-Indian Revenue Service
Income-Tax Advisor

☎ Office : (020) 26133012
: (020) 40024949
Residence : (020) 40044332
Email : sktyagidt@airtelmail.in

Flat No.2, (First floor)
Gurudatta Avenue
Popular Heights Road
Koregaon Park
PUNE-411 001