R.M. AMBERKAR
(Private Secretary)

IN THE HIGH COURT OF JUDICATURE AT BOMBAY
O.O.C.J.

INCOME TAX APPEAL NO. 173 OF 2017

The Commissioner of Income Tax (Exemptions) .. Appellant

Versus

Mehta Charity Trust .. Respondent

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- Mr. N.C. Mohanty for the Appellant
- Dr. K. Shivram, Sr. Counsel a/w Mr. Sashank Dundu i/by Rahul Hakani for the Respondent

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CORAM : AKIL KURESHI &
SARANG V. KOTWAL, JJ.

DATE : MARCH 19, 2019.

P.C.:

1. This appeal is filed by the Revenue to challenge the judgment of the Income Tax Appellate Tribunal (“the Tribunal” for short) raising following question for our consideration:-

> " Whether on the facts and in the circumstances of the case and in law, the Tribunal is justified in allowing the capital gain of Rs. 1,69,65,500/- as exempt under Section 11(1) of the Act, even though the assessee trust has not fulfilled the conditions prescribed under the provisions of Section 11(1A)(a) of the Act?"

2. Brief facts are as under:-

2.1 Respondent assessee is a Charitable Trust. During the period relevant to assessment year 2004-05, the Trust had granted tenancy rights in relation to two of its immovable properties. By way of premium, the Trust had received sum of Rs. 1.69 crores (rounded off). Such income was applied by the Trust for the purpose of its charitable objects. The Trust filed the return of income in which said receipt was not offered to tax. The Assessing Officer passed the order of assessment under Section 143(3) read with Section 147 of the Income Tax Act, 1961 ("the Act" for short) in which he held that the said receipt was in the nature of capital gain upon transfer of capital asset. He was of the opinion that the assessee had not invested such capital gain as provided in Section 11(1A) of the Act and therefore, such receipt was not exempt from tax.

3. In appeal, the CIT(A) noted that the assessee had applied a sum of Rs. 4.72 crores towards the objects of the Trust. This included the receipt of Rs. 1.69 crores received by way of premium. He, therefore, allowed the assessee's appeal upon which the Revenue approached the Tribunal. The Tribunal confirmed the view of the CIT(A) observing that the total income credited to the account of the Trust was Rs. 3.29 crores and the application towards objects of the Trust was Rs. 4.72 crores. The Tribunal, therefore, hold that the assessee had applied the said sum of Rs. 1.69 crores for the objects of the Trust.

4. Having heard the learned counsel for the parties, we notice that Section 11 of the Act pertains to income from property held for charitable or religious purposes. Under sub-section (1) of Section 11, subject to the provisions of Sections 62 to 63, the incomes specified in various clauses contained therein would not be included in the total income of the previous year of the person in receipt of the income. Sub-section (1A) was inserted in Section 11 by Finance Act of 1971 w.e.f. 1.4.1962. Clause (a) of sub-section (1A) provides that for the purposes of sub-section (1), where a capital asset, being a property held under trust wholly for charitable or religious purposes is transferred and the whole or any part of the net consideration is utilized for acquiring another capital asset, then the capital gain arising from the transfer shall be deemed to have been applied for charitable or religious purpose to the extent provided in the said provision. Sub-section (1A) of Section 11 is thus enabling provision by which a Trust who has has on transfer of capital asset made a capital gain, upon investment of such amount in another capital asset, would avoid payment of tax under a deeming fiction that such sum would be deemed to have been applied to charitable or religious purposes. Sub-section (1A) of Section 11 in no way restricts the applicability of sub-section (1) of Section 11.

5. This aspect clearly emerges from the explanatory notes to the provisions of Finance Act of 1971. Relevant portion of these notes explained in detail the reason for insertion of sub-section (1A) of Section 11 and the object for which the said sub-section was inserted. Relevant portion of these instructions read as under:-

> "73. Capital gains derived by charitable and religious trusts. - Under section 11, income derived from property held under trust for charitable or religious purposes is exempt from income-tax to the extent such income is actually applied to such purposes during the previous year itself or within three months next following. As "income"

includes "capital gains", a charitable or religious trust would forfeit exemption from income-tax in respect of its income by way of capital gains unless such income is also applied to the purposes of the trust during the stipulated period. In some cases, charitable or religious trusts are required to sell, in the interest of the trust, capital assets forming part of the corpus of the trust property solely with a view to acquiring other capital assets to be held as part of the corpus of trust. The requirement that the capital gains arising from such transactions should be utilized for charitable or religious purposes, during the accounting year itself or within three months immediately following, has the unintended effect of progressively reducing the corpus of the trust and the income yielded by it.

74. This difficulty has been accentuated as a result of certain amendments made in the scheme of tax exemption of charitable and religious trusts through the Finance Act, 1970. Under one of these amendments, a charitable or religious trust would forfeit exemption from tax on its income if the trust funds, constituting its corpus or income, are invested in a concern in which the author or founder of the trust or any substantial contributor to it or any relative of such author, founder or contributor is substantially interested. Where the investment of the trust funds in such concern exceeds 5 per cent of the capital of the concern, exemption is forfeited in respect of the whole of the income of the trust, while in a case where the investment does not exceed 5 per cent, the exemption is lost only in respect of the income from such investment, the other income continuing to enjoy tax exemption. In order to enable charitable and religious trusts to change their investments suitably, without forfeiting exemption from tax, a specific provision was also made in the Income-tax Act to the effect that the aforesaid provisions would not apply in a case where the investment of the trust funds in the prohibited concerns does not continue after 31-12-1970. In order to avail of the benefit of this relaxation, many charitable or religious trusts divested themselves of investments in prohibited concerns

before 1-1-1971. If the provisions of the law were construed strictly, such trusts would have forfeited exemption from tax in respect of their income by way of capital gains arising from the transfer of such investments unless they applied such incomes to charitable or religious purposes during the relevant accounting year or within three months immediately following.

75. The question of eliminating the disadvantage to charitable or religious trusts in being obligated to spend away the capital gains arising from the transfer of assets constituting the corpus of the trust instead of adding to the corpus, was considered by Government in 1963 and administrative instructions were issued to the effect that where a charitable or religious trust transferred a capital asset forming part of the corpus of its property solely with a view to acquiring another capital asset for the use and benefit of the trust and utilized the capital gains arising from the transaction in acquiring a new capital asset, the amount of capital gains so utilized should be regarded as having been applied to the charitable or religious purposes of the trust. These instructions have recently been reiterated.

76. With a view to placing the aforesaid administrative instructions on a legal footing and removing the disadvantage to charitable and religious trusts for the past as also the future, section 11 has been amended, by section 5 of the Finance (No. 2) Act, 1971 by way of insertion of a new sub-section (1A). Under the new sub-section, it has been provided that in a case where a capital asset being property held under trust for charitable or religious purposes is transferred and the whole or any part of the net consideration for the transfer (i.e., full value of the consideration as reduced by the expenditure incurred wholly and exclusively in connection with the transfer) is utilized for acquiring another capital asset to be held as part of the corpus of the trust, the capital gain arising from the transfer will be regarded as having been applied to charitable or religious purposes. Where the whole of such net consideration is

utilized in acquiring the new capital asset, the entire amount of the capital gain will be regarded as having been applied to charitable or religious purposes, while in a case where only a part of the net consideration is utilized for acquiring the new capital asset, an amount, if any, by which the cost of acquisition of the new asset exceeds the aggregate of the cost of acquisition of the capital asset transferred and the cost of any improvements made to such asset, will be regarded as having been applied to such purposes."

6. Under these circumstances, it can be seen that the Revenue cannot target the assessee's capital gain with the aid of sub-section (1A) of Section 11 when in terms of sub-section (1) to Section 11 itself, in view of the assessee's application of such gain for the objects of the Trust, there arose no tax liability. In the result, the Income Tax Appeal is dismissed.

[SARANG V. KOTWAL, J.] **[AKIL KURESHI, J]**