WHETHER CHARITIES ARE ENTITLED TO DEPRECIATION

QUESTION: This is with reference to your column in The Hindu dated December 27, 2010, on whether charities are entitled to depreciation. I am attaching a judgment dated October 26, 2010, of the Cochin bench of the ITAT-Lissie Medical Institutions-8 taxmann.com 82. The Tribunal has unfortunately held that a charitable institution under Sec. 12A is not eligible for depreciation in respect of capital assets which have been considered for application of income as capital expenditure incurred for furtherance of its objects based on an inappropriate understanding of the decision of the Supreme Court in Escort's case 199 ITR 43. The bench, I am afraid, has not appreciated the two stages in computation of income in the case of a charitable trust, namely, determination of income and application of income so clearly brought out by your reply.

I request you to discuss this judgment with comments in your column for the benefit of all readers.

ANSWER: The above query, points out that the view expressed in The Hindu dated December 27, 2010, runs the risk of non-acceptance by the Income-tax Department in view of the Tribunal decision cited by the reader. But the answer did make a reference to the High Court decision in CIT v Manav Mangal Society (2010) 328 ITR 421 (P&H) at 423, which reads as under:

"The amount spent on construction of school building at Panchkula is a capital expenditure but for the purpose of Sec. 11, it is an outgoing which is application of the income of the appellant for charitable purpose. The appellant shall also be entitled to claim depreciation on the school building."

Special leave application filed by the Income-tax Department against this decision has also since been dismissed by the Supreme Court vide Income Tax Reports (2010) 328 ITR (St.) 9. In view of the above, the decision of the Tribunal which did not have the benefit of the High Court decision, can no longer be good law, since the decision of the High Court supersedes that of the Tribunal. The departmental appeal in both these cases should not have been authorised at all.

The decision of the Supreme Court in Escorts Ltd. v Union of India (1993) 199 ITR 43 (SC) was followed by the Tribunal probably by a "bare browse of its catch note", as stated in the decision of the Tribunal while referring to it. The bar in Sec. 35(2) (iv) against depreciation on the basis of which Escorts' case (supra) was decided is made light of, notwithstanding the admitted "absence of express embargo" in the case of depreciation for other assets, especially of charities.

There are other misdirections in the decision of the Tribunal in law. After admitting that depreciation is an expenditure the Tribunal endorses the assessing officer's view that it would lead to "anomalous situation", if the

income is reduced by the amount of depreciation, since it is “a non-cash charge” and that, if permitted, the assessee could utilise such amount for non-charitable purposes, an inference which is patently incorrect. So is the inference that the insertion of clause (d) in Sec. 11(1) to bring the computation of applicable income in line with Sec. 12 with effect from April 1, 1989, for exclusion of corpus donations from the purview of applicable income nullifies the decisions of the courts allowing depreciation. Depreciation is being conceded by the Income-tax Department itself having accepted the decisions relying up a Board Circular No.5P(LXX-6) dated June 19, 1968. There is no further circular on the point. The arguments of revenue in the departmental appeal were with reference to Sec. 14A and the decision in CIT v Queens' Educational Society (2009) 319 ITR 160 (Uttarakhand).

The Tribunal found Sec. 14A to be inapplicable and made no reference to Queens Educational Society's case, which was not on the point at all.

The Direct Taxes Code Bill, 2010, however, would allow the entire investments in assets used for the objects of a charitable trust or institution as a deduction from the income so that the balance amount alone is to be utilised.

If it comes into force, there would be no need for depreciation, when the cost of asset is allowed in full. This, however, is not possible under the present law.

In fact, the assessee in the case before the Tribunal could have no objection to the denial of depreciation, if the cost of the asset had been allowed in computation of income required to be applied. Disallowance of both cost of the asset and depreciation would require application of income which will erode its corpus.

Source: The Hindu