

HON'BLE SRI JUSTICE GODA RAGHURAM
AND
HON'BLE SRI JUSTICE M.S. RAMACHANDRA RAO

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I.T.T.A. Nos. 35, 45, 46, 63 and 64 of 2011

%28.02.2013

M/s.Chirec Education Society, Hyderabad.

...APPELLANT

VERSUS

\$ Assistant Director of Income Tax (E), Hyderabad.

...RESPONDENT

< **GIST:**

> **HEAD NOTE:**

!Senior Counsel for Appellant: Sri S.Ravi.

**^Standing Counsel for Respondent: Sri
J.V.Prasad.**

? Cases referred

[1] Order dt.11-11-2010 in W.P.Nos.21248 of 2010 and batch

² (1990) 183 ITR 377 (A.P.)

³ (1987) 168 ITR 516 (Raj)

⁴ (2009) 178 TAXMAN 436 (Delhi)

⁵ (1992) 196 ITR 31 (All)

⁶ (1997) 227 ITR 356 (S.C.)

⁷ (1997) 227 ITR 203 (Kerala)

⁸ (2008) 297 ITR 66 (Delhi)

⁹ (2003) 263 ITR 13 (A.P.)

¹⁰ Rao Shiv Bahadur Singh Vs. State of U.P.....AIR 1953 S.C. 394.

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I.T.T.A. Nos. 35, 45, 46, 63 and 64 of 2011

COMMON JUDGMENT:

(Per Hon'ble Sri Justice M.S. Ramachandra Rao)

These five appeals are filed under Section 260A of the Income Tax Act, 1961 (for short "the Act") by the assessee challenging the common order dt.30-07-2010 in I.T.A.Nos.282 to 286/Hyd/06 for the assessment years 1998-99 to 2002-03.

2. M/s.Sri Shakti Schools Pvt. Ltd. (for short "SSSPL") was incorporated in the year 1989 and had established a corporate run school in Hyderabad under the name and style "Chirec". In 1997, SSSPL applied to the Central Board of Secondary Education (for short "CBSE") for recognition of the school. CBSE denied recognition on the ground that the school is being run by a private limited company and insisted that a properly constituted registered society of non-proprietary character was required to be constituted. In order to fulfill the said condition laid down by

CBSE, Directors of SSSPL formed the assessee society and registered it under the Public Societies Registration Act, 1350 Fasli. The assessee took on lease premises (a building bearing No.1-22 and an extent of Ac.5.52 cents in Serilingampally Mandal, Ranga Reddy District) belonging to SSSPL under a registered lease deed dt.25-06-1997. The Directors of SSSPL are members of the assessee-Society. The assessee was granted affiliation by CBSE.

3. SSSPL retained its identity and continued the educational activity in Pre-primary-1 (PP1), Pre-primary-2, L.K.G. and U.K.G. sections, in the name of Chirec Pre-school, without recognition from the CBSE.

4. The assessee paid rent for the building and playground belonging to SSSPL as per the lease agreement dt.25.6.1997 and royalty for using the name "Chirec", under an agreement dt.1.4.1997. The royalty amount is 20% of the total fee received from the students on rolls as at the beginning of the year and was paid in three installments. As per a letter dt.7.2.2005 of the assessee given to the assessing officer, royalty is being paid to SSSPL for extensive use of its famous and established brand name "Chirec" and against part reimbursement of various amounts spent by SSSPL for the huge infrastructure and for services and facilities rendered by SSSPL as at the time of the agreement, SSSPL had

transferred to the assessee students numbering over 400 from Classes I to VI apart from teaching staff.

5. For the above assessment years, when the assessee sought exemption under Section 11 of the Act, the assessing officer by separate orders all dt.18.3.2005 denied it on the ground that the pre-condition for an educational institution is to impart education on non-profit motive; the profit arising from its activity is not to be distributed among the members and should be utilized for building up the infrastructure to impart education with non-profit motive; the assessee is not becoming self-sufficient but is dependent on SSSPL and the latter is taking out huge receipts of the assessee in the shape of rent and royalty; whenever educational society develops its own infrastructure and conditions as stipulated for, at the time of its winding up, the entire infrastructure of the society has to be transferred to the other society with same objects; but in the case of the assessee, whenever amounts were received in excess of expenditure are being distributed to SSSPL members who are also members of the assessee for their benefit in the form of rent and royalty; as per Section 13 (1) (c) of the Act, the founder members of the assessee are having substantial interest in another concern (SSSPL) which is benefiting from the assessee and therefore exemption under Section 11 of the Act cannot be granted. He disallowed the payments made

towards royalty by the assessee to SSSPL and added the same to the returned income. He also disallowed 20% of the rent paid for the structures.

6. The assessee preferred appeals before the CIT (Appeals)-IV, Hyderabad. By order dt.12-01-2006, he allowed the appeals and held that the assessee is entitled to exemption under Section 11 of the Act. He held that the issue is not whether royalty payment is allowable or not; the issue is whether the quantum of royalty payment is reasonable or not; the assessing officer has given a finding that the royalty payment is in lieu of the name "Chirec" and other associated facilities and services parted by SSSPL while transferring the infrastructure to the assessee; the nexus of royalty with parting of name and infrastructure etc. cannot be ruled out; it is in the character of business payment; in the remand report, the assessing officer has only stated that "reasonableness (of royalty) cannot be determined" and thus failed to establish as to what should be the reasonable amount of royalty payment; consequently the order of the assessing officer is unsustainable once reasonableness of the royalty payment cannot be determined; that no reasonable man would transfer user rights of name and other benefits without charging adequate consideration; that the royalty paid for the assessment year in question cannot be said to be unreasonable; that the assessing officer also erred in

disallowing 20% of the rent simply on adhoc basis without conducting any enquiry for collecting information about comparable cases or asking the assessee for clarification; and that the assessing officer was also not correct in ignoring the hire charges for equipment of Rs.1.20 lakhs.

7. Revenue challenged the orders of the CIT (Appeals) before the Income Tax Appellate Tribunal, Hyderabad Bench-B, Hyderabad (for short 'the Tribunal'). The appeals were numbered as I.T.A.Nos.282 to 286/Hyd/2006.

8. By a common order dt.30-07-2010, appeals of the Revenue were partly allowed by the Tribunal. The Tribunal held that in case of charitable institutions, income derived from property held under Trust wholly for charitable or religious purposes shall be applied for the object for which the institution was created; in the present case, royalty is being paid to a private limited company engaged in commercial activities; SSSPL is not a company incorporated under Section 25 of the Companies Act, 1956 having charitable objects; it is a company registered for commercial purposes and cannot be called a company engaged in charitable activity; if any funds are diverted by a Trust registered under Section 12-A or claiming exemption under Section 11 for the benefit of any members of the assessee trust or any company in which members of the

assessee trust are substantially interested, then provisions of Section 13 (1) of the Act are attracted; if an activity of charitable institution is caught by Section 13, the provisions of Section 11 or 12 would not apply; the assessee made payment to SSSPL in which members of the assessee are substantially interested and the entire share capital of SSSPL is owned by members of the assessee society; therefore funds of the assessee are utilized for benefit of persons specified in Section 13 (1) (c) of the Act; members of the assessee society are interested persons in SSSPL; therefore funds of the assessee society were diverted for benefit of SSSPL amounting to spending for personal benefits of members of SSSPL; that payment of royalty by assessee to SSSPL cannot be said to have been incurred for the purpose of business of assessee; there is no merit in contention of the assessee that payment of royalty resulted in getting a readymade school with all infrastructure including students and staff as SSSPL is not entitled to run a school having failed to get approval from CBSE; SSSPL carried on Preschool classes for which CBSE approval is not required; there is no compulsion for Pre-school students of SSSPL to join the assessee's institution only and they could join any educational institution they like; even the staff are not bonded employees of SSSPL and there is no contract between SSSPL and its staff to work with the assessee; similar is the

situation with the students; as SSSPL did not get approval from CBSE to run the school, the members of the assessee society entered into a collusive transaction to transfer the profit of the assessee society to interested persons and get business deduction for the royalty payment; and the assessing officer rightly withdrew the exemption under Section 11 invoking Section 13 (1) (c) and taxed the income of the assessee. It however upheld the finding of CIT (Appeals) on the issue of rent reduction and equipment hire charges.

9. Challenging the common order of the Tribunal, the present appeals have been preferred by the assessee.

10. Heard Sri S.Ravi, learned senior counsel for Sri Ch.Pushyam Kiran, learned counsel for the appellant/assessee and Sri J.V.Prasad, learned Senior Standing Counsel for the respondents/Revenue.

11. The learned counsel for the assessee contended that it paid royalty to SSSPL equivalent to 20% of the fees received from students towards usage of registered trade name "Chirec" and the logo for running the school which also belonged to SSSPL; payments of royalty were made in terms of agreement dt.01-04-1997; SSSPL paid income tax on the rent as also royalty received from the appellant; the CIT (Appeals) rightly called for a remand

report from the assessing officer specific to the question of reasonableness of the royalty paid; as the assessing officer did not give any finding with regard to the reasonableness of the royalty payment, the CIT (Appeals) rightly held that the claim of royalty payment cannot be held to be unreasonable and directed assessing officer to accept the appellant's case in that regard; the Tribunal's view that there was diversion of income of the assessee to SSSPL which had not been incorporated under Section 25 of the Companies Act, 1956 and that its activities are hit by the provisions of Section 13 of the Act is untenable and perverse; the Tribunal erred in law in holding that mere payment of royalty for usage of name to SSSPL would disentitle the assessee to benefit of exemption under Section 11 irrespective of whether such payment is reasonable payment or not; and the assessing officer and the Tribunal erred in not noticing sub section (2) of Section 13 which requires an enquiry into the reasonableness and adequacy of a payment by an assessee trust to interested persons mentioned in sub section (3) of Section 13.

M/s.New Noble Education Society Vs. Chief Commissioner of Income Tax^[1]; CIT Vs. Polisetty Somasundaram Charities^[2]; Shree Poongalia Jain Swetamber Mandir Vs. CIT^[3]; Director of Income Tax Vs. Span Foundation^[4];and CIT Vs. J.K.Charitable

Trust^[5] were relied on by him.

12. The learned standing counsel for the respondent however supported the order of the Tribunal and contended that sub section (2) of Section 13 of the Act has no application at all to the facts of the case; even if it is applied, sub clause (g) of sub section (2) of Section 13 would come into operation and the royalty payment by the assessee to SSSPL would amount to diversion of the assessee's income to a person referred to in clause (e) of Section 13 (3); therefore there is no warrant to interfere with the findings of the Tribunal. He relied upon **CIT Vs. Rattan Trust**^[6], **CIT Vs. Muthoottu Charitable Trust**^[7], **Kanahya Lal Punj Charitable Trust Vs. Directorate of Income Tax (Exemption)**^[8] and **AWARE Vs. Deputy Commissioner of Income Tax**^[9].

13. We have noted the respective contentions of the respective parties.

14. Admittedly the assessee was formed as a society registered under the Public Societies Registration Act, 1350 Fasli by members of SSSPL after the application of SSSPL to the CBSE was rejected and the assessee had taken the premises belonging to SSSPL with infrastructure on lease under a lease agreement dt.25-06-1997 to run the school

and is paying rent to SSSPL. Under an agreement dt.1.4.1997, SSSPL is also receiving as royalty from the assessee, 20% of the total fee received from the students on rolls as at the beginning of the year.

15. It is the contention of the assessee that SSSPL is paying the royalty for usage of the brand name "Chirec" and also the infrastructure, tangible and intangible benefits created by SSSPL; that it could secure a readymade school with all infrastructure including students from SSSPL and that the payment of royalty by it to SSSPL is reasonable and allowable and therefore it is entitled to exemption under Section 11 of the Act.

16. It is not disputed by the Revenue that the CIT (Appeals) called for a remand report from the assessing officer on the issue whether the quantum of royalty payment is reasonable or not, and in the remand report dt.12-12-2005 submitted by the assessing officer to the CIT (Appeals), he had specifically stated that the reasonableness of the payment of royalty cannot be determined.

17. S.13 of the Act states:

"13. Section 11 not to apply in certain cases .

(1) Nothing contained in section 11 or section 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof-

(a) any part of the income from the property held

under a trust for private religious purposes which does not enure for the benefit of the public;

(b) in the case of a trust- for charitable purposes or a charitable institution created or established after the commencement of this Act, any income thereof if the trust or institution is created or established for the benefit of any particular religious community or caste;

(c) in the case of a trust for charitable or religious purposes or a charitable or religious institution, any income thereof-

(i) if such trust or institution has been created or established after the commencement of this Act and under the terms of the trust or the rules governing the institution, any part of such income enures, or

(ii) if any part of such income or any property of the trust or the institution (whenever created or established) is during the previous year used or applied, directly or indirectly for the benefit of any person referred to in sub-section (3):

Provided that in the case of a trust or institution created or established before the commencement of this Act, the provisions of sub- clause (ii) shall not apply to any use or application, whether directly or indirectly, of any part of such income or any property of the trust or institution for the benefit of any person referred to in sub- section (3), if such use or application is by way of compliance with a mandatory term of the trust or a mandatory rule governing the institution:

Provided further that in the case of a trust for religious purposes or a religious institution (whenever created or established) or a trust for charitable purposes or a charitable institution created or established before the commencement of this Act, the provisions of sub- clause (ii) shall not apply to any use or application, whether directly or indirectly, of any part of such income or any property of the trust or institution for the benefit of any person referred to in sub- section (3) in so far as such use or application relates to any period before the 1st day of June, 1970 ;

(d) In the case of a trust for charitable or religious purposes or a charitable or religious institution, any

income thereof, if for any period during the previous year-

(i) any funds of the trust or institution are invested or deposited after the 28th day of February, 1983 otherwise than in any one or more of the forms or modes specified in sub- section (5) of section 11; or

(ii) any funds of the trust or institution invested or deposited before the 1st day of March, 1983 otherwise than in any one or more of the forms or modes specified in sub- section (5) of section 11 continue to remain so invested or deposited after the 30th day of November, 1983 ; or

(iii) any shares in a company[not being a Government company as defined in section 617 of the Companies Act, 1956

(1 of 1956), or a corporation established by or under a Central, State or Provincial Act are held by the trust or institution after the 30th day of November, 1983 : Provided that nothing in this clause shall apply in relation to-

(i) any assets held by the trust or institution where such assets form part of the corpus of the trust or institution as on the 1st day of June, 1973 ;

(ia) any accretion to the shares, forming part of the corpus mentioned in clause (i), by way of bonus shares allotted to the trust or institution;

(ii) any assets (being debentures issued by, or on behalf of, any company or corporation) acquired by the trust or institution before the 1st day of March, 1983 ;

(iia) any asset, not being an investment or deposit in any of the forms or modes specified in sub- section (5) of section 11, where such asset is not held by the trust or institution, otherwise than in any of the forms or modes specified in sub- section (5) of section 11, after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st day of March, 1993 whichever is later;

(iii) any funds representing the profits and gains of business, being profits and gains of any previous year relevant to the assessment year commencing on the 1st day of April, 1984 or any subsequent assessment year.

Explanation.- Where the trust or institution has any other income in addition to profits and gains of business, the provisions of clause (iii) of this proviso shall not apply unless the trust or institution maintains separate books of account in respect of such business. Explanation.- For the purposes of sub- clause (ii) of clause (c), in determining whether any part of the income or any property of any trust or institution is during the previous year used or applied, directly or indirectly, for the benefit of any person referred to in sub- section (3), in so far as such use or application relates to any period before the 1st day of July, 1972 , no regard shall be had to the amendments made to this section by section 7 other than sub- clause (ii) of clause (a) thereof of the Finance Act, 1972 .

(2) Without prejudice to the generality of the provisions of clause (c) and clause (d) of sub- section (1), the income or the property of the trust or institution or any part of such income or property shall, for the purposes of that clause, be deemed to have been used or applied for the benefit of a person referred to in sub- section (3),-

(a) if any part of the income or property of the trust or institution is, or continues to be, lent to any person referred to in sub- section (3) for any period during the previous year without either adequate security or adequate interest or both;

(b) if any land, building or other property of the trust or institution is, or continues to be, made available for the use of any person referred to in sub- section (3), for any period during the previous year without charging adequate rent or other compensation;

(c) if any amount is paid by way of salary, allowance or otherwise during the previous year to any person referred to in sub- section (3) out of the resources of the trust or institution for services rendered by that person to such trust or institution and the amount so paid is in excess of what may be reasonably paid for such services;

(d) if the services of the trust or institution are made available to any person referred to in sub- section (3) during the previous year without adequate remuneration

or other compensation;

(e) if any share, security or other property is purchased by or on behalf of the trust or institution from any person referred to in subsection (3) during the previous year for consideration which is more than adequate;

(f) if any share, security or other property is sold by or on behalf of the trust or institution to any person referred to in subsection (3) during the previous year for consideration which is less than adequate;

(g) if any income or property of the trust or institution is diverted during the previous year in favour of any person referred to in subsection (3):

Provided that this clause shall not apply where the income, or the value of the property or, as the case may be, the aggregate of the income and the value of the property, so diverted does not exceed one thousand rupees;

(h) if any funds of the trust or institution are, or continue to remain, invested for any period during the previous year (not being a period before the 1st day of January, 1971) in any concern in which any person referred to in subsection (3) has a substantial interest.

(3) The persons referred to in clause (c) of subsection (1) and subsection (2) are the following, namely:-

(a) the author of the trust or the founder of the institution;

(b) any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds [fifty] thousand rupees;

(c) where such author, founder or person is a Hindu undivided family, a member of the family;

(CC) any trustee of the trust or manager (by whatever name called) of the institution;

(d) any relative of any such author, founder, person, member, trustee or manager as aforesaid;

(e) any concern in which any of the persons referred to in clauses (a), (b), (c), (cc) and (d) has a substantial interest.

(4) Notwithstanding anything contained in clause (c) of subsection (1) [but without prejudice to the provisions

contained in clause (d) of that sub- section], in a case where the aggregate of the funds of the trust or institution invested in a concern in which any person referred to in sub- section (3) has a substantial interest, does not exceed five per cent of the capital of that concern, the exemption under section 11 1[or section 12] shall not be denied in relation to any income other than the income arising to the trust or the institution from such investment, by reason only that the 2[funds] of the trust or the institution have been invested in a concern in which such person has a substantial interest.

(5) Notwithstanding anything contained in clause (d) of sub- section (1), where any assets (being debentures issued by, or on behalf of, any company or corporation) are acquired by the trust or institution after the 28th day of February, 1983 , but before the 25th day of July, 1991 , the exemption under section 11 or section 12 shall not be denied in relation to any income other than the income arising to the trust or the institution from such assets, by reason only that the funds of the trust or the institution have been invested in such assets if such funds do not continue to remain so invested in such assets after the 31st day of March, 1992 .

Explanation 1-For the purposes of sections 11, 12, 12A and this section," trust" includes any other legal obligation and for the purposes of this section" relative", in relation to an individual, means-

- (i) spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) any lineal ascendant or descendant of the individual;
- (v) any lineal ascendant or descendant of the spouse of the individual;
- (vi) spouse of a person referred to in sub- clause (ii), sub- clause (iii), sub- clause (iv) or sub- clause (v);
- (vii) any lineal descendant of a brother or sister of either the individual or of the spouse of the individual.

Explanation 2.- A trust or institution created or established for the benefit of Scheduled Castes, backward classes, Scheduled Tribes or women and children shall not be deemed to be a trust or institution

created or established for the benefit of a religious community or caste within the meaning of clause (b) of sub-section (1).

Explanation 3.- *For the purposes of this section, a person shall be deemed to have a substantial interest in a concern,-*

(i) in a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than twenty per cent of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of the other persons referred to in sub-section (3)

(ii) in the case of any other concern, if such person is entitled, or such person and one or more of the other persons referred to in sub-section (3) are entitled in the aggregate, at any time during the previous year, to not less than twenty per cent of the profits of such concern."

18. In our view Section 13 is an adjunct to Section 11 and exemption of income from property held for charitable purposes under Section 11 cannot be granted where the activity of a charitable institution comes within the purview of Section 13. But the sub-sections (1) (c) and (2) have to be read *not in exclusion to each other but harmoniously*. If sub-section (1) (c) of Section 13 is considered in isolation ignoring sub-section (2) thereof, then parting of any part of the income of a Trust to a person referred to in sub-section (3) of Section 13 would be impermissible. But the rigor of Section 13 (1) (c) is mitigated by sub-section (2) of Section 13 and it would view only those transactions of the type mentioned therein (such as grant of loan/lease/payments by way of salary, allowance or otherwise) where the benefit

conferred on the persons specified in sub section (3) by the Trust *is in excess of what is considered adequate or reasonable* which would warrant denial of exemption under Section 11. It is a settled principle of interpretation of statutes that the Court should avoid a construction which would render a part of the statute devoid of any meaning or application.^[10] Therefore it is not possible to ignore the provisions of sub section (2) of Section 13 (as contended by the Revenue) while deciding the question whether the assessee is entitled to the exemption under Section 11 of the Act. It is true that the words “*Without prejudice to the generality of the provisions of clause (c) and clause (d) of sub- section (1)*” occurring in sub-section (2) of Section 13 suggest that the provisions of sub-section (2) should not be understood as cutting down the provisions of clause (c) and clause (d) of sub-section (1) of section 13 but this does not mean that in a situation like the present where sub-section (2) can apply, it should be ignored.

19. The next question to be considered is whether the act of the assessee in paying royalty amounts to diversion of the funds of the assessee attracting clause (g) of sub section (2) Section 13. In our considered view, this contention of Revenue is also not tenable since royalty is being paid by the assessee to SSSPL for using the name “Chirec” which belongs to SSSPL and towards part reimbursement of various amounts spent by SSSPL for

huge infrastructure and for services and facilities rendered by SSSPL. At the time of agreement for payment of royalty, the SSSPL has transferred students from classes I to VI numbering over 400 and also teaching staff. It is not disputed that CBSE had imposed a condition that it would grant recognition only to a society specifically incorporated for the purpose of running a school as a non-profit organization and therefore members of SSSPL had no option but to register the assessee society under the Public Societies Registration Act, 1350 F and then to transfer its entire paraphernalia, infrastructure etc. to it for its use. If the assessee had taken the infrastructure and the trade name of somebody (other than SSSPL), it cannot be disputed that the assessee would incur similar expenditure (like the one being paid to SSSPL towards royalty) as no reasonable man would transfer user rights of name and other benefits without charging adequate consideration. Therefore merely because such facility was provided by SSSPL and royalty was being paid to it by the assessee in that behalf, Revenue cannot contend that it is impermissible.

20. Revenue may probably contend that amount paid is unreasonable and more than what is due, but this not it's plea. Revenue's stand is that it's reasonableness cannot be determined. In this situation, if Revenue is not able to establish that the royalty paid by the assessee to SSSPL is unreasonable, it has to be inferred that it is adequate and

reasonable. If this is so, then royalty paid by the assessee to SSSPL ought to be considered as coming within clause (c) of sub section (2) of Section 13 under the category amount paid “otherwise” during the previous year to SSSPL out of resources of the Trust for services rendered by it (which is not excessive or unreasonable).

21. Therefore, Revenue’s contention that this amounts to diversion of funds by the assessee to SSSPL and clause (g) of sub section (2) of Section 13 is attracted is misconceived since payment of royalty is necessary to secure the use of the trade name and infrastructure of SSSPL. Therefore the view of the CIT (Appeals) that the assessee is entitled to the benefit of Section 11 is valid and was liable to be interfered with.

22. We therefore hold that the observations of the Tribunal that income of the assessee is given to SSSPL, a company whose activity is commercial and not charitable; that payment of royalty by the assessee is not incurred for purpose of the assessee’s business; that the students or staff of SSSPL were not bound to join the assessee once it was formed by SSSPL; and the payment was intended to benefit the members of assessee society; that it is a collusive transaction to transfer the profit of the assessee society to interested persons; are wholly irrelevant and perverse. Tribunal appears to have misdirected itself and

considered totally irrelevant issues.

23. We are of the view that the assessing officer and the Tribunal have failed to consider sub section (2) of Section 13 and have simply concentrated on clause (c) of sub section (1) of Section 13.

24. In **M/s.New Noble Education Society** (1 supra), this Court held that the provisions of Section 13 (1) (c) would be attracted only in cases where any part of the income, or property of a charitable institution, is used, directly or indirectly, for the benefit of a person referred to in Section 13 (3) of the Act; that under Section 13 (2), income or property of the institution shall, for the purposes of Section 13 (1) (a), be deemed to have been used or applied for the benefit of a person referred to in Section 13 (3) if any one of the classes (a) to (h) of Section 13 (2) are applicable; the person referred to in Section 13 (3) would be benefited only if the amount paid to him constitutes a benefit to him or if clauses (a) to (h) of Section 13 (2) are attracted. In that case, it was held that if the rent paid is more than prevailing market rate only, the recipient of the rent can be said to have benefited thereby and the assessee can be denied benefit of Section 11 and on similar logic approval under Section 10 (23-C) (vi) of the Act.

25. In **Polisetty Somasundaram Charities** (2 supra),

this Court held that the income of a trust held wholly for charitable or religious purposes is exempt from tax subject to the conditions regarding application of income in S.13; that provisions in Section 13 have been jumbled up and lack a systematic layout and arrangement of sub-sections; that Section 13 cuts at the exemption visualized under Section 11 and the exemption contemplated under Section 11 is hedged in by the conditions catalogued in Section 13 apart from the built-in conditions in Section 11. The Court held that in the context of lending of money, such activity as such is not prohibited and Section 13 (2) (a) provides that exemption cannot be denied if adequate security is taken. But investment as such is prohibited under Section 13 (2) (h) and the plea of the Revenue in that case that there was an investment by the assessee is untenable as the amount is advanced at 12% interest which is normal and adequate.

26. In **Shri Poongalia Jain Swetamber Mandir** (3 supra), the Rajasthan High Court held that one has to look at the adequacy of the interest paid on money lent by a trust to determine whether its activity comes under Section 13 (2) (a). If the rate of interest being paid on money lent by the appellant trust is same as the rate of interest being paid by banks on fixed deposits or if adequate security is provided, the trust would be entitled to exemption under Section 11.

27. In **Span Foundation** (4 supra), it was held that if the assessee let out its premises to persons mentioned in S.13(3) and derived rents therefrom and such rents were more than the standard rent as computed under the Delhi Rent Control Act, 1958, they have to be treated as adequate and the assessee cannot be denied exemption u/section 11 and 12 of the Act.

28. In **J.K.Charitable Trust** (5 Supra), it was held that where adequate interest/rent is charged by the assessee, trust on loans advanced and buildings leased out to certain concerns, they are not hit by S.13 (2) (a) and the assessee is entitled to exemption u/section 11.

29. The above decisions also support our view that reasonableness or adequacy of payments by an assessee to the interested person have to be necessarily gone into (under Section 13 (2)) to determine whether the assessee would be entitled to exemption of income u/Section 11.

30. In **Rattan Trust** (6 Supra) cited by the Revenue, the Supreme Court considered the effect of amendments to Section 13 of the Act and Section 21 A of the Wealth Tax Act, 1957 by the Finance Act, 1970 w.e.f. 1.4.1971. The provisos thereto laid down that exemption under Section 11 will not be denied if part of income or property of the trust or institution created before 1.4.1962, is applied for benefit

of a person referred to in sub-section (3) of section 13 of the Act, if such use or application is in compliance with mandatory terms of the trust. In that case, there was no such provision in the trust deed dt.28.3.1942 of the assessee but was sought to be introduced by way of amendment to the trust deed dt.14.3.1971 i.e after 1.4.1962 invoking a clause in the trust deed authorizing making of amendments to the trust deed. The Court said that such a mandate in the trust deed should have existed before 1.4.1962 and could not have been brought in by amending the trust deed at a later stage after that crucial date, even if the trust deed so authorized the trustees to amend the trust deed to bring in the mandatory condition or requirement for them to invest funds of the trust in a concern in which they might be interested. It held that any other interpretation would set at naught the proviso and would defeat the very purpose for which the proviso was added in Section 13. This case is of no assistance to Revenue. Merely because the assessee was registered by SSSPL to run the school after SSSPL's application for approval was rejected by CBSE, it cannot be said that assessee's payment by way of royalty to SSSPL is prohibited and consequently the assessee deprived of exemption u/Section 11 .

31. The Kerala High Court in **Muthoottu Charitable Trust**

(7 Supra) denied exemption under Section 11 to a trust created by members of a family (and whose entire income was derived from a chit fund run by the same family) when its funds were found to be with the said firm doing chit fund business invoking Section 13 (1) (c) (ii) and Section 13 (3).

32. In **Kanahya Lal Punj Charitable Trust** (8 Supra), where huge sums were advanced by the assessee trust without taking adequate security or charging interest to a Company having substantial interest in the Trust, the Delhi High Court denied exemption under S.11 to the assessee.

33. In **AWARE** (9 Supra), this court held that funds of the assessee were misused and diverted deliberately as its Chairman Madhavan took a loan in the name of the Chairman and gave it to one of the members without adequate security and consideration and provisions of section 13 (1) (c) (ii) r/w Section 13 (2) (b) and section 13 (3) (d) were violated. In that case for purchase of land also, the assessee had routed the entire transaction through an association of persons in which all the members were directors and employees of the assessee.

34. **Muthoottu Charitable Trust** (7 supra), **Kanahya Lal Punj Charitable Trust** (8 Supra) and **AWARE** (9 Supra) cited by the Revenue were decided on the facts

noted therein that activities of the respective assessee trusts' were carried on in violation of provisions of Section 13. We are unable to discern any principle of general application which could be of assistance to Revenue in the present case.

35. We therefore allow these appeals and set aside the common order dt.30.7.2000 in ITA No.s 282 to 286/Hyd/2006 of the Tribunal and restore the orders dt.12.1.06 of the Commissioner of Income Tax (Appeals) – IV, Hyderabad for the assessment years 1998-99 to 2002-03. No costs.

JUSTICE GODA RAGHURAM

JUSTICE M.S.RAMACHANDRA RAO

28-02-2013

Note:

L.R.Copy to be Marked.

B/o.

Kvr

[\[1\]](#) Order dt.11-11-2010 in W.P.Nos.21248 of 2010 and batch

[\[2\]](#) (1990) 183 ITR 377 (A.P.)

[\[3\]](#) (1987) 168 ITR 516 (Raj)

[\[4\]](#) (2009) 178 TAXMAN 436 (Delhi)

[\[5\]](#) (1992) 196 ITR 31 (All)

[\[6\]](#) (1997) 227 ITR 356 (S.C.)

[\[7\]](#) (1997) 227 ITR 203 (Kerala)

[\[8\]](#) (2008) 297 ITR 66 (Delhi)

[\[9\]](#) (2003) 263 ITR 13 (A.P.)

[\[10\]](#) Rao Shiv Bahadur Singh Vs. State of U.P.....AIR 1953 S.C. 394.