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Impact analysis of the Supreme Court decision in *Saraf Exports* v. *CIT*: Worth the wager?

By Krishna Laasya V

The article in this issue of Direct Tax Amicus discusses a recent decision of the Supreme Court in the case of *Saraf Exports* v. *CIT*, wherein the Apex Court has held that export incentives like Duty Drawback and DEPB will not qualify as first-degree nexus for the purposes of claim of deduction under Section 80-IB of the Income Tax Act, 1961. The decision has also reiterated the principle laid down earlier that restrictive meaning must be given to the expression 'derived from'. The article in this regard discusses the prominent decisions highlighted in this decision, and the judicial standing in various preceding decisions. Noting that the term 'derived from' has also been employed in other provisions of the Income Tax Act as well, the author points out that the factum of being able to ascribe the meaning of the term to usage in other similar provisions seems likely to be subject to litigation as well. The author also raises a pertinent question as to whether the ratio of this decision would also apply to other export incentives and all other incentives from the Government such as MEIS/SEIS scrips or those that may be rolled out in the future.

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Impact analysis of the Supreme Court decision in *Saraf Exports* v. *CIT*: Worth the wager?

Introduction

The Hon'ble Supreme Court ('**Hon'ble SC**') recently pronounced its judgment in the case of *Saraf Exports* v. *CIT* [Civil Appeal No. 4822 of 2022], settling the issue of entitlement of deduction under Section 80-IB of the Income-tax Act, 1961 ('**IT Act**') with respect to receipts under Duty Drawback Scheme ('**DDS**') and on transfer of Duty Entitlement Pass Book Scheme ('**DEPB**'). The taxpayer was engaged in the business of manufacture and export of wooden handicrafts. For the exports undertaken by it, the taxpayer was entitled to benefits under certain schemes framed under the Customs Act, 1962. During the subject period, the taxpayer received certain incentives under the DDS and DEPB. The benefits were claimed as deduction under Section Section 80-IB of the IT Act, as being 'derived from' its industrial undertaking of manufacturing wooden handicrafts. The Revenue Authorities, however, denied the claim on the ground that the said benefit was a separate source of income and cannot be treated as 'derived' from the industrial undertaking of the taxpayer. On subsequent appeals, the High Court too held against the taxpayer. The taxpayer subsequently filed an appeal before the Hon'ble SC. Before analysing the decision of the Hon'ble SC, it is pertinent to analyse the dichotomy in various judicial precedents passed by various judicial forums.

Prominent decisions highlighted in Saraf Exports

The Hon'ble SC in *Liberty India* v. *CIT* [317 ITR 218 (SC)] had analyzed whether the profits from DDS and DEPB can be said to be profit 'derived from' the business of industrial undertaking and eligible for deduction under Section 80-IB. It was held that the schemes are incentives which flow from the schemes of the Central Government or the Customs Act. It was held that the said profits from DEPB, DDS cannot be linked to 'profits derived from industrial undertaking' as they are ancillary profits. The decision also held that cost of purchase includes duties and taxes which are directly attributable to such purchase. It was held that DEPB and DDS should be treated as separate items of revenue or income and not as part of the cost of purchases. Such schemes constitute an independent source of income beyond the first degree of nexus to the profits and industrial undertaking.

The Hon'ble SC in *CIT* v. *Meghalaya Steels* [383 ITR 217 (SC)] ruled that various subsidies including transport, power, interest

and insurance qualify for deduction under Sections 80IB and 80IC. 'Direct Nexus' test was applied to hold that the subsidies have direct nexus with business or profession and specifically that the profits and gains as termed in Sections 80IB and 80IC have reference to net profit. Net profit can only be calculated by deducting elements of manufacturing or selling cost from the sale price of the product. That being so, the profits which are arrived at, after deduction of the manufacturing and the selling costs reimbursed to the assessee by the Government are derived from the business of the assessee.

Judicial standing in preceding judicial decisions

The Hon'ble Rajasthan High Court in *CIT* v. *Garment Crafts* [(2016) 68 taxmann.com 222 (Rajasthan)] held that DEPB and DDS do not form part of net profit of undertaking as they are not derived from eligible business but are incentives under a particular scheme. Thus, they are not allowable as deduction under Section 80-IB. Similar views were upheld by the Hon'ble Gujarat High Court in *Banpal Oil Chem (P) Ltd* v. *ACIT* [(2016) 71 taxmann.com 342 (Gujarat)], Hon'ble Bombay High Court in *CIT* v. *Rachna Udhyog* [(2010) 1 taxmann.com 29 (Bombay)]. The Hon'ble SC in *Pandian Chemicals Ltd.* v. *CIT* [(2003) 129 Taxman 539 (SC)] held that the words 'derived from' must be understood as something that has direct or immediate nexus with an industrial undertaking.

The Hon'ble Rajasthan High Court in *Saraf Seasoning Udyog* v. *ITO* [(2008) 174 Taxman 594 (Rajasthan)] held that income derived from sale of DEPB license is profit and gain from industrial undertaking and so, is eligible for deduction under Section 80-IB. The Hon'ble SC in *B. Desraj* v. *CIT* [(2008) 171 Taxman 481 (SC)] held that the words 'business profits' as mentioned in Section 80HHC (3) of the IT Act include duty drawback and so deduction should be allowed.

Hon'ble SC decision in Saraf Exports

The Hon'ble SC held that in the light of the decisions of *Liberty India* and *Sterling Foods,* the decision of the High Court would not require any intervention. The Court observed that the decision of *Meghalaya Steels* deals with certain subsidies given by the State Government which directly affect cost of manufacturing and therefore has a direct nexus with profits and gains of the undertaking. The Court also specifically observed that the decision of *Liberty India* was not disapproved in *Meghalaya Steel.*

Conclusion

The decision of the Hon'ble SC upheld the ratio laid down in *Liberty India* and *Sterling Foods* to ultimately hold that export incentives will not qualify as first-degree nexus for the purposes of claim of deduction under Section 80-IB. The decision has reiterated the principle laid down earlier that restrictive meaning must be given to the expression 'derived from'.

It is pertinent to bring to light that the term 'derived from' has been employed in other provisions of the IT Act as well. Section 11(a) of the IT Act provides for income 'derived from' property, Section 12(1) of the IT Act provides for income 'derived from' property held under trust wholly for charitable or religious

purposes. The factum of being able to ascribe the meaning of the term to usage in other similar provisions seems likely to be subject to litigation as well.

Another food for thought would be to observe whether the ratio of this decision would also apply to other export incentives and all other incentives from the Government such as MEIS/SEIS scrips or those that may be rolled out in the future, *vide* various judicial decisions and other allied interpretations.

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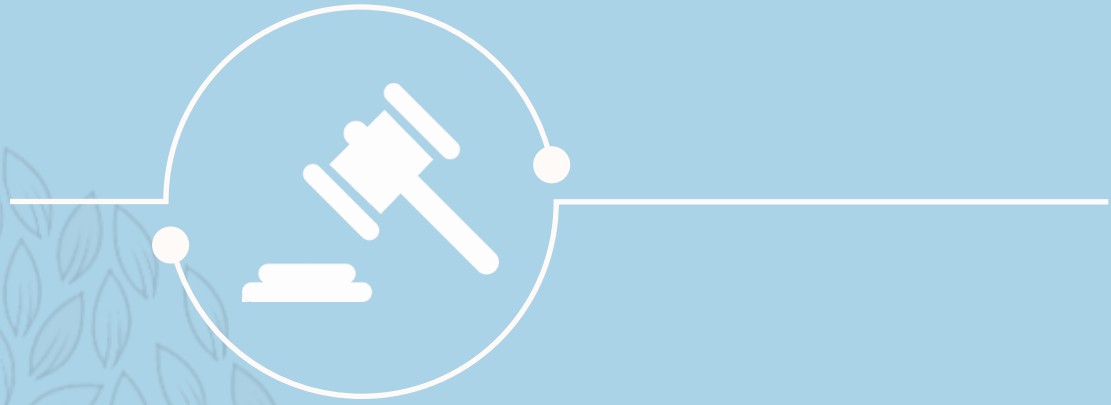
Notifications & Circulars



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Notifications & Circulars

Online gaming – Rules for calculation of net winnings notified

Section 194BA of the IT Act requires every person responsible for paying any income by way of winnings from any online game during the FY to deduct income tax on the net winnings at the time of withdrawal(s), if any, and/ or at the year-end, at the rates in force. The method to compute the net winnings on which tax is to be deducted was required to be prescribed.

Accordingly, Rule 133 has been inserted in the Income-tax Rules, 1962 ('**IT Rules**') *vide* Notification No. 28 dated 31 May 2023, which provides for calculation for net winnings which are to be subjected to tax at source.

Before referring to such computation, it is *sine qua non* to refer certain terms used therein and the meaning assigned to them:

- **User Account:** Every account of the user which is registered with the online gaming intermediary.
- **Non-taxable Deposits:** Amount deposited by the user in his user account, and which is not taxable. That is, the amount directly transferred by the user from his bank account or other modes to wallet.
- **Taxable Deposits:** Amount deposited in the user account which is not a non-taxable deposit and includes any amount paid directly to the user not through the user account. This also includes winnings in kind and bonus, referral bonus, incentives, promotional money, discount, etc.

Computation of 'net winnings' at the time of First Withdrawal

The formula for the computation of 'net winnings' at the time of First Withdrawal is as under:

Net Winnings = A – (B + C)*

Where,

A = Aggregate amount withdrawn from the user account

B = Aggregate amount of non-taxable deposits made in the user account by the owner of such account (i.e., the User) during the financial year, till such withdrawal

C = Opening balance of the user account at the beginning of the financial year

**Net Winnings shall be 0, if withdrawal is less than (Non-taxable deposits + Opening balance)*

Computation of 'net winnings' at the time of Subsequent Withdrawal

The formula for the computation of "net winnings" at the time of Subsequent Withdrawal is as under:

Net Winnings = A – (B + C + E)*

Where,

A = Aggregate amount withdrawn from the user account till the time of subsequent withdrawal (including such subsequent withdrawal)

B = Aggregate amount of non-taxable deposits made in the user account by the user during the financial year, till such subsequent withdrawal

C = Opening balance of the user account at the beginning of the financial year

E = Net Winnings in earlier withdrawal(s) on which tax has been deducted u/s. 194BA

**Net Winnings shall be 0, if withdrawal is less than (Non-taxable deposits + Opening balance + Net Winnings which has suffered TDS)*

Computation of 'net winnings' at the time of Year-end

The formula for the computation of "net winnings" at the time of Year-end is as under:

Net Winnings = (A + D) – (B + C + E)*

Where,

A = Aggregate amount withdrawn from the user account during the financial year

B = Aggregate amount of non-taxable deposits made in the user account by the user during the financial year

C = Opening balance of the user account at the beginning of the financial year

D = Closing balance at the end of the financial year

E = Net Winnings in earlier withdrawal(s) on which tax has been deducted u/s. 194BA

**Net Winnings shall be 0, if (Withdrawal + Closing balance) is less than (Non-taxable deposits + Opening balance + Net Winnings which has suffered TDS)*

Online gaming – Guidelines for removal of difficulties in relation to TDS on winnings issued

Section 194BA, inserted w.e.f. 1 April 2023, provides for deduction of tax at source in respect of 'net winnings' from online gaming. Section 194BA(3) authorizes CBDT to issue guidelines to remove any difficulties and in pursuance to the same, the following guidelines have been issued by way of Circular 5 dated 22 May 2023:

- Whenever there are multiple user accounts of the same user, each user account will be considered for the purpose of calculating net winnings.
- Deposits from borrowed funds shall be considered as non-taxable deposit.
- Treatment of bonus, referral bonus and other incentives:
    - Bonus, referral bonus, incentives, etc. given by the online game intermediary to user shall be taxable deposits.
    - Where deposits of such bonus, incentives etc. are in the nature of coins, coupons and vouchers, equivalence in money of such deposit shall be treated as taxable deposit.
    - Where incentive / bonus is only credited to user for the purposes of playing and cannot be withdrawn or used for other purposes, such deposit shall be ignored in calculation of net winnings as per Rule 133. A separate account must be maintained in respect of such deposit by the person liable to deduct tax. In a scenario where such deposit is recharacterized and allowed to be withdrawn, the deposit will be treated as taxable deposit at the time of recharacterisation.
- Transfer from one user account to another maintained with the same online gaming intermediary, will not be considered as withdrawal of deposit. However, when an amount is withdrawn from the user account to any another account, it is considered a withdrawal.
- Where coupons for purchase of goods and services or some item in kind is issued in consideration of amount in user account, the same is considered as withdrawal.
- Tax may not be deducted on withdrawal where net winnings comprised in amount withdrawn do not exceed INR 100 in a month. TDS ought to be deducted as and when the net winnings exceed INR 100 in a month (including the winnings on which TDS was not deducted earlier on account of being less than INR 100) and/ or at the end of the year on the entire net winnings.
- If winnings from a game are in kind, it shall be the responsibility of the person responsible for paying to ensure that the tax has been paid in relation thereto. Alternatively, the person responsible for paying may pay the TDS out of his own pocket.
- In case of winnings in kind, the fair market value shall be the amount of winnings. Where the online gaming intermediary has purchased the winnings before providing it to the user, then the purchase price shall be construed as the value of winnings. In a case where the items are manufactured by the online gaming intermediary, then the price that it charges to the customers for such items shall be reckoned as the value of winnings. GST will not be included for the purposes of valuation of winnings.

- In case of a shortfall in deduction of tax due to time lag in issuance of Rule 133 or the present circular, the same may be deposited with the tax deduction for the month of May 2023 by 7 June 2023, to avoid penal consequences.

Leave encashment – Exemption limit for cash equivalent of leave salary at the time of retirement increased

Section 10(10AA)(ii) of the IT Act provides that leave encashment received at the time of retirement by an employee (other than an employee of the Central or State Government), whether on superannuation or otherwise, shall be excluded from computation of total income subject to such limit as the Central Government may specify by way of Notification in the Official Gazette.

In pursuance of the same, *vide* Notification No. SO 588(E) dated 31 May 2002, the exemption limit for employees was specified to be INR 3,00,000/-.

Vide the present Notification No. 31 dated 24 May 2023, the exemption limit for leave encashment on retirement as provided for under Section 10(10AA)(ii) of the IT Act has been increased to INR 25,00,000/-.

E- Appeals Scheme, 2023 notified

The e-Appeals Scheme has been made by the Central Government in exercise of powers conferred by Section 246(5) of the IT Act:

- The Scheme shall be applicable to appeals in respect of persons/ cases, as covered under Section 246 of the IT Act except the cases excluded under Section 246(6) of the IT Act.
- As per the Scheme, the Joint Commissioner (Appeals) ('**JCIT(A)**') is the Appellate Authority conferred with powers to dispose appeals filed, allocated or transferred to it in accordance with the provisions of the Scheme.
- An appeal against JCIT(A) Order will lie before the Hon'ble Income Tax Appellate Tribunal ('**ITAT**') having jurisdiction over the jurisdictional Assessing Officer of the Appellant.
- If any Order passed by JCIT(A) is set aside or remanded back by the Hon'ble ITAT or Hon'ble High Court or Hon'ble Supreme Court, the Order shall be assigned to a JCIT(A) for further action in accordance with the Scheme.
- Hearing shall be conducted through video conferencing or video telephony.

Charitable and religious trusts – Clarification regarding provisions relating thereto issued

Income of any fund or institution or trust or any educational institution or hospital or other medical institution referred to under Section 10(23C)(iv–via) of the IT Act or trust or institution registered under Section 12AA or 12AB of the IT Act is exempt, subject to fulfillment of conditions.

Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 amended the provisions related to application and approval of registration or approval by amending the first and second proviso to Section 10(23C), Section 12A(1)(ac), 12AB and 80G(5).

Vide Circular No. 6 dated 24 May 2023, the CBDT has provided clarity in respect of provisions relating to trust, as under:

Extension of due dates

- Finance Act, 2023 amended Section 115TD to provide that accreted income of trusts which has not applied for registration or approval within the stipulated time will be liable to tax. Based on representations received citing genuine hardships faced by Trusts in applying for registration/approval, the CBDT has now extended the due dates of filing Form No. 10A and Form No. 10AB till 30 September 2023 where the due date for making the application has expired prior to such date.
- CBDT has also extended the due date for furnishing statement of donation in Form No. 10BD and certificate of donation in Form No. 10BE to 30 June 2023 for FY 2022-23.

Clarification regarding applicability of provisional registration

- In order to bring consistency, trusts, funds, institutions seeking provisional registration / approval, such provisional registration / approval shall be effective from the AY relevant to the PY in which the application is made and shall valid for 3 years subject to Section 10(23C)(iii), 12A(1)(ac)(iii) or clause (iii) of first proviso to Section 80G(5) of the IT Act.

Clarification regarding denial of exemption where statement of accumulation is not filed before due date

- Considering the representations received by the trusts that Form No. 10 and Form No. 9A may not be filed before finalization of Return of income, it has been clarified that accumulated/deemed application shall not be denied as long as the statement of accumulation and deemed accumulation in Form 10 and Form 9A are furnished on or before the due date of filing the return of income under Section 139(1) of the IT Act.

Clarification regarding audit report to be furnished in Form No. 10B

- For the purposes of filling Form No. 10B and Form No. 10BB, it has been clarified that electronic modes referred

to in Section 6ABBA of the IT Rules are in addition to payments made through an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account.

Refund claim and claim of carry forward of losses – Monetary limits of concerned authority revised for seeking condonation of delay

Circular No. 7 dated 31 May 2023 modifies Circular No. 9 dated 9 June 2015 and revises the monetary limits and concerned authority for deciding claims of refund and of carry forward of losses:

- If the amount of claim does not exceed INR 50 lakh for any AY, the power to accept /reject lies with the Principal Commissioners of Income tax / Commissioners of Income tax.
- If the amount of claim exceeds INR 50 lakh but is less than INR 2 crore for any AY, the power to accept / reject vests with the Chief Commissioner of Income tax.
- If the amount of claim exceeds INR 2 crore but is less than INR 3 crore for any AY, the power to accept / reject vests with the Principal Chief Commissioner of Income tax.
- If the amount of claim exceeds INR 3 crore, the power to accept / reject vests with CBDT.

Ratio Decidendi

- No TDS liability on year-end provisions reversed in the subsequent AY, when payee was not identifiable – ITAT Delhi
- Primary Agricultural Credit Societies cannot be termed as co-operative bank/ bank under Banking Regulation Act, for the purpose of Section 80(P)(4) of the IT Act – Supreme Court
- Assessment order is not rectifiable on jurisdictional issue, once the order passed in appeal against the order has attained finality – ITAT Hyderabad
- Derivative loss allowed to be set off against other business income by virtue of Sections 43(5) and 73 – Bombay High Court
- Trust cannot claim exemption under Section 80G merely because it has registration under Section 12AA – ITAT Pune

Ratio Decidendi

No TDS liability on year-end provisions reversed in the subsequent AY, when payee was not identifiable

The assessee made year-end (AY 2013-14) provisions for expenses pertaining to advertisement and sales promotion, legal and professional fees and interest on loan. Since the payees of the said expenses were not ascertainable, the assessee did not deduct tax at source for the same. The Assessee was treated as 'assessee-in-default' under Section 201(1) of the IT Act.

Before the ITAT, the assessee submitted that payees of the said expenses were not ascertainable as the invoices were received by the Assessee in the subsequent AY. Further, the said provisions were subsequently reversed in the subsequent AY and expenses were booked on receipt of the invoices.

The Hon'ble ITAT relied on the decisions of *UCO Bank* v. *Union of India* [369 ITR 335] and *DCIT* v. *Ericsson Communications* [378 ITR 395 (Del)] to hold that no liability to deduct tax at source arises when the payee is not ascertainable. It was further observed that if the amount and the payee are not ascertainable, the machinery provisions of recovering tax deducted at source fails as it does not aid the charge of tax under Section 4 of the IT Act but takes a form of separate levy, independent of other provisions of the IT Act. Therefore, the ITAT held that the assessee cannot be considered as 'assessee-in-default'. [*HT Mobile Solutions Ltd.* v. *JCIT* – TS-275-ITAT-2023 (DEL)]

Primary Agricultural Credit Societies cannot be termed as co-operative bank/ bank under Banking Regulation Act, for the purpose of Section 80(P)(4) of the IT Act

The question of law involved in this case was whether the Respondent/assessee being a credit society engaged in the activity of giving credit/loan to its members was justified to claim itself as a cooperative credit society and not a bank for the purpose of claiming exemption under Section 80(P)(2) of the IT Act.

It was argued on behalf of the Appellant/Revenue that the Assessee would fall under the definition of co-operative bank since the activity carried out by the assessee involves giving of credit/loan. In counter, the assessee argued that they would not be categorized as a co-operative bank/ bank under the Banking Regulation Act since the activities carried on by a bank are entirely different from those carried on by the Respondent/assessee.

The Hon'ble Supreme Court held, in view of the decision of the Supreme Court in *Mavilayi Service Coperative Bank* v. *CIT* [(2021)

7 SCC 90], that primary agriculture credit societies cannot be considered as a banking society under the Banking Regulation Act for the purpose of Section 80(P)(4) of the IT Act, and hence shall be entitled to exemption/benefit under Section 80(P)(2). [*PCIT* v. *Annasaheb Patil Mathadi Kamgar Sahakari Pathpedi Ltd*. – TS-233-SC-2023]

Assessment order is not rectifiable on jurisdictional issue, once the order passed in appeal against the order has attained finality

The assessee's appeals against the order passed under Section 143(3) read with Section 153A of the IT Act were dismissed by the CIT(A) and then, by ITAT. The assessee preferred no further appeal against the said ITAT Order.

Thereafter, the assessee filed three separate rectification applications on jurisdictional issue under Section 154 of the IT Act challenging the Assessment Order passed on the ground that notices ought to have been issued under Section 153C and not under 153A of the IT Act. However, the said applications were rejected by the AO *vide* a combined order on the ground that rectification proceedings under Section 154 of the IT Act cannot be used as a reviewing mechanism.

Aggrieved, the assessee appealed before the CIT(A) and the same was allowed relying on a Bombay High Court judgement in *Blue Star Engineering Co (Bombay) Ltd* v. *CIT* [73 ITR 283 (Bombay High Court)] which held that if rectification resulted in annulment of an assessment in toto, then such Assessment Order is to be quashed. The CIT(A) held that the notices issued under Section 153A ought to have been issued under Section 153C of the IT Act for the reason that when search itself was not on the HUF, a notice under Section 153A cannot be issued to the assessee in the capacity of a HUF and thus, the entire assessment proceedings fail.

Aggrieved, the Revenue filed an appeal before the ITAT. The issue before the ITAT was whether after finalization of assessment proceedings up to the level of ITAT, can an assessee file an application under Section 154 before AO raising the jurisdictional issue for the first time.

The Revenue contended that once the proceedings against the assessee had finalised and the statutory period for filing an appeal before the High Court has also lapsed, the assessee cannot resort to Section 154. as against this, the assessee contended that the issue of jurisdiction being legal in nature, can be raised during the proceedings under Section 154 or at any stage. It was further contended that since the jurisdiction of AO goes to the root of the matter, any order passed by an authority without jurisdiction becomes void *ab initio*.

The ITAT upon hearing both sides noted that an income tax authority does have the power to rectify any mistake that is apparent in its order. However, when the order of an AO is upheld by the CIT(A), and subsequently by the ITAT, the AO is barred from rectifying any mistake under Section 154, as doing so, would lead

to unrestrained powers to the AO/CIT(A) to unsettle the settled position of law, which would ultimately lead to chaos. The ITAT further noted that since the assessee did not prefer any appeal before the High Court, the Order passed by the ITAT eventually attained finality and becomes enforceable against the assessee.

The ITAT also reiterated the concept of 'doctrine of merger' which states that when a superior authority approves an Order passed by a lower authority, the Order of the lower authority merges with the Order of the superior authority. It was also observed that, the Tribunal cannot pass two contradictory orders, one upholding the assessment and the other quashing the assessment based on jurisdictional defect. In the circumstances, the appeal by the Revenue was allowed. [*ITO* v. *Krishna Kumar D Shah (HUF)* – TS-259-ITAT-2023 (HYD)]

Derivative loss allowed to be set off against other business income by virtue of Sections 43(5) and 73

The assessee was engaged in the business of collecting toll fees and carried on the business of shares and derivatives. For the year under consideration, the return filed by the assessee was picked up for scrutiny and the AO passed an Assessment Order making certain additions.

In the Assessment Order, the AO failed to consider the loss suffered by the assessee on transactions in derivatives while computing the net taxable income. A rectification application under Section 154 of the IT Act was filed and the same was rejected. On appeal, the CIT(A) upheld the Assessment Order holding that the assessee would not be entitled to set-off the loss suffered from transactions in securities, being a speculative transaction, against a non-speculative business income due to the application of Section 73 of the IT Act. The said view was also upheld by the ITAT.

Aggrieved, the assessee preferred an appeal before the High Court of Bombay. During the hearing, the assessee submitted that applying Explanation 2 to Section 28 read with proviso (d) to Section 43(5), such transactions in securities would be outside the definition of 'speculative transactions'. In support of this, reliance was placed on the Supreme Court judgement in *Snowtex Investment Ltd.* v. *PCIT* [2019 SCC OnLine SC 749] and the Bombay High Court judgement in *CIT* v. *Bharat Ruia,* [(2011) 337 ITR 452], wherein it was held that losses suffered by an assessee in transactions arising out of securities in derivatives or arisen from trading in futures and options were not speculative transactions or profits from speculative business as per Section 43(5) of the IT Act.

The Bombay High Court held that neither the ITAT nor the CIT(A) considered the effect of the proviso to Section 43(5) of the IT Act. The Court further held that the assessee did not claim any set-off of loss in transactions in shares where delivery was actually effected. The assessee claimed set-off with respect to only those losses which arose in transactions in derivatives. In *toto*, the assessee was allowed to claim set-off of loss in the said transactions in derivatives against the business income of the

assessee from infrastructure business under Section 70 of the IT Act. [*Souvenir Developers (I) Pvt. Ltd.* v. *Union of India* – TS-361-HC-2022 (BOM)].

Trust cannot claim exemption under Section 80G merely because it has registration under Section 12AA

In order to verify if the conditions under Section 80G(5) of the IT Act were fulfilled by the assessee based on an application filed by the assessee for granting of exemption under Section 80G, a notice was issued to the assessee-trust requesting to upload certain information regarding the commencement of activities, details of other law applicable for achievement of objectives, year-wise list of donations received, etc.

The assessee furnished a reply wherein it had mentioned that the trust did not conduct any activities for the FY 2019-20, 2020-21, 2021-22. However, in subsequent paragraphs of the same reply, it was mentioned that it had undertaken charitable activities. Considering the discrepancies in the aforesaid reply, the Commissioner sought for the objects of the trust to be submitted. In the submission of the assessee, it was noted that the assessee had made substantial expenditure for religious purposes. Section 80G(5B) of the IT Act provides that the expenditure during any previous year for religious purposes should not exceed 5% of the total income. Since the assessee made religious expenses exceeding the said 5% limit, the Commissioner held that the assessee violated Section 80G(5B) and thus the application of the assessee for grant of exemption under Section 80G was rejected.

Aggrieved, the assessee filed an appeal before the ITAT. It was submitted by the assessee that the expenses were voluntary in nature and out of the total expenses made, the expenses on electricity were substantial. The assessee submitted that on reduction of electricity expenses from the total expenses, the balance amount would fall within the permissible limit of Section 80G(5B) of the IT Act. It was also submitted that as per the objects of the trust, the assessee is not only engaged in religious activities, but also in other charitable activities for the benefit of society at large. The Department argued that there cannot be segregation of electrical expenses on the ground that religious activities cannot be undertaken without employing the use of electricity. That being the case, it cannot be submitted by the assessee that the electricity expenses must be removed from the total expenses.

The assessee also submitted that since it has registration under Section 12AA, exemption under Section 80G should be granted as an automatic course.

On due consideration to the objects clause of the Assessee, the ITAT observed that the majority of the objects undertaken by the assessee pertain to religious activities. Surplus, if any, can be spent on other charitable activities. Since electricity expenses are in direct relation to religious activities, all expenses are to be considered as a single expense incurred for religious purposes.

The ITAT also held that granting exemption under Section 80G only for the reason that registration under Section 12AA is

granted to the assessee is not an automatic course as both these provisions have been brought into force for distinct purposes. The ITAT also relied on *Sant Girdhar Anand Parmhans Sant Ashram* [2023] 452 ITR 52 (SC)] wherein it was held that to avail the benefit under Section 80G(5B) even though there is registration under Section 12AA, the requirements of Section 80G(5B) must be fulfilled separately.

Thus, the ITAT held that since for all the three FYs under consideration, the assessee spent more than 5% of its total income for religious purposes, the benefit of exemption under Section 80G was to be denied. [*Shri Kalaram Sansthan* v. *CIT* – 2023 (6) TMI 435 - ITAT Pune]

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